



NUCLEAR ENERGY INSTITUTE

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Vice President, Policy Development

July 2, 2007

Mr. Howard G. Borgstrom  
Director, Business Operations Center  
Office of the Chief Financial Officer  
U.S. Department of Energy  
Mailstop CF-60, Room 4A-221  
1000 Independence Avenue, S.W.  
Washington, DC 20585

**RE: Nuclear energy industry comments in response to Notice of Proposed Rulemaking on Loan Guarantees for Projects that Employ Innovative Technologies (RIN 1901-AB21), 72 Federal Register 27471 (May 16, 2007)**

Dear Mr. Borgstrom:

On behalf of the U.S. nuclear energy industry, the Nuclear Energy Institute<sup>1</sup> and NEI's New Plant Oversight Committee (NPOC)<sup>2</sup> appreciate the opportunity to provide comments on the Notice of Proposed Rulemaking (NOPR) published by the Department of Energy (72 *Federal Register* 27471 May 16, 2007). This NOPR proposed regulations to implement Title XVII of the Energy Policy Act of 2005, and solicited public input on those proposed regulations. Title XVII authorizes the Secretary to guarantee up to 80 percent of the cost of projects that (i) avoid, reduce or sequester air pollutants or greenhouse gases, and (ii) employ new or significantly improved technologies.

The nuclear energy industry shares the Department of Energy's interest in a loan guarantee program that has disciplined management, rigorous project evaluation and reasonable limits on the government's exposure. As these comments explain, however, the Department of Energy's proposed regulations to implement the loan guarantee program do not represent a workable approach to implementation of Title XVII of the 2005 Energy Policy Act. We believe that it is possible to structure the program in a manner that protects the interests of the taxpayers and promotes the deployment of innovative technologies that

<sup>1</sup> NEI is responsible for establishing unified nuclear industry policy on matters affecting the nuclear energy industry, including regulatory, financial, technical and legislative issues. NEI members include all companies licensed to operate commercial nuclear power plants in the United States, nuclear plant designers, major architect/engineering firms, fuel fabrication facilities, materials licensees, and other organizations and individuals involved in the nuclear energy industry.

<sup>2</sup> NEI's New Plant Oversight Committee (NPOC) consists of the chief executives or chief nuclear officers of the companies that have announced plans to develop applications for construction/operating licenses (COLs) for new nuclear power plants and the nuclear plant designers. NPOC provides a mechanism to establish industrywide consensus on regulatory, financial and other significant policy issues associated with new nuclear plant development.

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achieve the purposes set forth by Congress. We note the success of the recent experience with the Air Transportation Stabilization Board, where the government approved \$1.6 billion in loan guarantees, with a single default of \$20 million, and net revenues of about \$300 million from the sale of stock and warrants.<sup>3</sup>

The proposed regulations published by the Department of Energy (DOE) on May 16, 2007, differ only slightly from the Guidelines for the loan guarantee program published in August 2006. The major difference involves an adjustment in the loan coverage – from 80 percent coverage of the loan amount in the 2006 Guidelines to 90 percent coverage in the 2007 NOPR. This change has no impact on the viability of the program. NEI provided the DOE a detailed assessment of the flaws in those Guidelines on January 24, 2007. At that time, NEI stated: “Initial implementation of the loan guarantee program, as reflected in the guidelines published by DOE in August 2006, would not support financing of new baseload nuclear power plants. If the approach reflected in the guidelines is carried forward into implementing regulations, the loan guarantee program will not contain the critical ingredients to support financing of new nuclear projects.”

Unfortunately, that is now the case with the proposed regulations.

- The rule proposed by the Department of Energy has, at its center, a financing structure that is not workable, creating a hybrid loan facility for which there is no market – a guaranteed debt component that should enjoy triple-A credit and an unsecured, unguaranteed debt component that is effectively “quasi-equity,”<sup>4</sup> coupled with a prohibition against stripping the guaranteed tranche from the unguaranteed tranche so that each tranche could move to its natural market. This structure would actually have the perverse effect of compromising a project’s economics, increasing debt service requirements, and increasing costs to electricity consumers.
- The energy loan guarantee program proposed bears little resemblance to other successful federal government loan guarantee programs in many important respects. Other loan guarantee programs generally provide for 100 percent coverage of the loan amount; allow *pari passu* treatment of unguaranteed commercial debt (where project sponsors choose to finance using a tranche of commercial debt); permit stripping of guaranteed debt from unguaranteed debt, and follow standard practice in project finance by including credit subsidy costs along with other financing costs in project cost. The proposed rule is deficient on all four basic structural issues. According to OMB data<sup>5</sup>, the successful formulas adopted in other federal loan guarantee programs have leveraged benefits on the order of 20-to-1, while holding default levels to about 1 percent of the government-wide portfolio. The structural weaknesses in the proposed rule could limit the prospect for achieving comparable performance with the energy loan guarantee program.
- The proposed rule shows that the Executive Branch has virtually ignored substantive input since the August 2006 Guidelines were published from stakeholders with an interest in an effective,

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<sup>3</sup> “U.S. Profits from Airline Loan Guarantee Program,” *Reuters*, January 29, 2007.

<sup>4</sup> For example, the Maritime Administration allows any subordinated, non-guaranteed loans to be included in project equity for purposes of project risk assessment and fee determination (See 65 CFR 298.36 (b)(4)).

<sup>5</sup> For information on loan guarantee default levels government-wide, see *Analytical Perspectives*, Budget of the U.S. Government, Table 7-6, p.95. For information on benefits of other federal loan guarantee programs, see individual Program Assessment Rating Tool reports at [www.whitehouse.gov/omb/expectmore](http://www.whitehouse.gov/omb/expectmore). For example, the ExIm Bank long-term loan guarantee program achieved \$23 of export value for every \$1 in appropriations costs, and for all credit programs the Bank achieved an average of \$18 of value per \$1 in costs. MARAD achieved over \$17 of shipyard activity for every \$1 of budget subsidy costs in three of the past four years.

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disciplined program, including the financial institutions that will provide the debt financing for new nuclear power plants<sup>6</sup> and members of Congress<sup>7</sup> who have clarified that Congressional intent contemplated 100 percent loan coverage. We believe that the Department has a responsibility to consider this input.

The nuclear industry believes an effective loan guarantee program must have three defining characteristics:

- The guarantee itself must be a viable financing instrument, in line with other federal loan guarantee instruments;
- The program requires a transparent methodology for calculating the credit subsidy cost to be paid by project sponsors, and such costs should be reasonable and commercially viable, and
- The program requires certainty on the availability of loan guarantees and should be insulated from the uncertainty associated with the annual appropriations process.

It will be a formidable challenge to finance the advanced electric generating technologies needed to (1) meet growing U.S. demand for baseload electricity over the next 15 to 20 years, (2) increase energy independence, and (3) meet more stringent environmental standards.

The new nuclear plants now in the early stages of development are large, capital-intensive projects that employ innovative new designs that have not yet been commercially deployed in the U.S. These projects are about to enter a new and untested federal licensing process. Absent federal loan guarantees, these projects will have great difficulty in accessing capital markets, particularly since the investment in new nuclear capacity coincides with a period of heavy capital investment by the electric sector in other types of generating capacity, transmission, distribution, demand-side management and environmental control technologies. All of these investments are necessary to ensure the continued safe and reliable operation of the United States electricity system.

Addressing this challenge successfully will require innovative approaches to financing, combining all the financing capabilities and tools available to the private sector, the federal government and state

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<sup>6</sup> See the March 7, 2007, letter from a group of five investment banks to Energy Secretary Samuel Bodman (Appendix I). Also, in testimony before the Senate Energy and Natural Resources Committee on March 7, 2007, commenting on the 2006 Guidelines, Jerome Peters, senior vice president of TD Banknorth N.A., stated: "The DOE Guidelines undercut that protection in two significant ways. First, they limit the guarantee to 80 percent of the loan amount, shifting 20 percent of the technology risk to the lender, and seem to prohibit the substitution of additional equity to make up for the unguaranteed portion of the debt. The addition of this technology risk component will significantly reduce the pool of lenders willing to participate in the program and will result in higher rates to the project developers. Even more damaging to lender interests, is the fact that the DOE Guidelines require that any commercial debt brought into a project must be subordinate to the government-guaranteed debt."

<sup>7</sup> In a May 3, 2007, letter to President Bush, the Chairmen and Ranking Members of the House Energy and Commerce Committee and its Energy and Air Quality Subcommittee stated: "We have been told that the Administration is considering a generic standard for this program that could generally limit Federal guarantees to 80 percent of the debt portion of a project, or 64 percent of total capital financing requirements. We urge you not to propose such a guideline .... [I]nvestments under Title XVII could suffer." (See Appendix II for copy of letter.) As a measure of Congressional frustration with the Executive Branch's failure to implement Title XVII as intended, the energy legislation (H.R. 6) that passed the Senate on June 21, 2007, includes a provision mandating 100 percent loan coverage for Title XVII loan guarantees. The energy legislation approved by the House Energy and Commerce Committee on June 28, 2007, includes a similar provision.

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governments. The loan guarantee program authorized by Title XVII of the Energy Policy Act of 2005 is one of the most important financing tools available, and should be modeled on the successful financing techniques already employed by the federal government (through such agencies as the Export-Import Bank and the Overseas Private Investment Corp.).

The loan guarantee program is not a subsidy. Under the terms of the statute, project developers expect to pay the credit subsidy cost of the loan guarantee, as well as the full cost of administering the program. The program is needed to address market imperfections that otherwise would restrict access to capital markets or impose inordinately high cost of capital on projects. As noted by OMB, federal credit programs, such as the Title XVII program, "effectively fill the gaps created by market imperfections."<sup>8</sup>

The industry is seeking to work with the Department to craft a program that will achieve this goal at no cost to the taxpayers. The nuclear energy industry is confident that it is possible to balance the federal government's legitimate need to protect the taxpayers' interest and the private sector's legitimate need for credit support to finance innovative technologies. Given a rational approach to implementation, in which projects are selected based on a high likelihood of commercial success with the loan guarantees, there will be minimal risk of default and therefore minimal risk to the taxpayer.

If you have any questions about these comments, please contact me at 202.739.8021 or at [rjm@nei.org](mailto:rjm@nei.org).

We appreciate the opportunity to provide comments on the loan guarantee NOPR, and thank you in advance for considering them.



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<sup>8</sup> See pp. 67-68 of *Analytical Perspectives*, Budget of the U.S. Government, Fiscal Year 2008, for a more detailed discussion of market imperfections in credit markets and the role of federal loan guarantees.

**I. The Need for, and Importance of, the Loan Guarantee Program**

**A. The investment challenge facing the U.S. electric sector**

Over the past 15 years the electric power sector has invested heavily in new gas-fired generation and in upgrading existing baseload generating assets but has not invested in new capital-intensive baseload generating technologies.

The lack of investment in new, technologically advanced generation was the result of a confluence of events, including (1) relatively high generating capacity margins throughout the United States, (2) the development of lower-capital-cost, mid-merit, gas-fired generation during a period of relatively low-cost supplies of natural gas and oil, (3) longer-term investment uncertainty associated with the continued development of competitive electricity markets and the market rules governing these regional electricity markets, and (4) difficulties in obtaining permits. As a result, investment in new coal and nuclear generating capacity all but disappeared, even though these two fuel sources represent 70 percent of U.S. electricity supply and provide the greatest price stability.

Between 1992 (when the Energy Policy Act mandated competition at the wholesale level and open access to the transmission system) and 2005, the United States commissioned only 8,000 megawatts of new coal-fired capacity and 2,500 megawatts of nuclear capacity. During that same period, however, generating companies built approximately 290,000 megawatts of new gas-fired capacity. Gas-fired capacity was preferred because it represented the lowest possible investment risk since it could be built quickly and had low capital cost.

It is now clear, however, that the construction of large amounts of gas-fired capacity has placed unsustainable demand on natural gas supply, which will increase U.S. dependence on foreign sources of natural gas (through increasing imports of LNG). This has resulted in high prices for natural gas, and these higher costs are reflected in higher costs of electricity to consumers. It is equally clear that U.S. electricity markets need new baseload generating capacity, and that the U.S. electric industry is on the threshold of a major construction cycle for new baseload generating capacity and new electric transmission. Consensus estimates suggest that the industry, over the next 15 years, must invest between \$750 billion and \$1 trillion in new generating capacity, new transmission and distribution infrastructure and environmental controls. This new capital spending represents a major challenge to the electric power industry.

**B. Nuclear plant financing challenges**

The Energy Policy Act of 2005 recognized this financing challenge and provided limited investment stimulus for construction of new baseload power plants. That stimulus includes production tax credits for new nuclear plants, investment tax credits for advanced coal-based projects, and authorization for a loan guarantee program within the Department of Energy to support financing and commercial deployment of innovative technologies that reduce emissions.

Of the three major incentives for new nuclear power plant development provided by the Energy Policy Act – the production tax credit, the standby support and the energy loan guarantee program authorized by Title XVII – the loan guarantee program is clearly the most effective in addressing the major challenge facing new nuclear power plant construction, which is construction financing.

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The production tax credit somewhat improves the financial attractiveness of a project after it is in commercial operation, but the construction period is when a new nuclear project most needs credit support and the production tax credit provides no help at that time. The standby support or delay insurance against licensing or litigation delays has a number of shortcomings, including the fact that it is limited to debt service, and provides no coverage for the other substantial delay costs that would be incurred by a nuclear project subject to licensing or litigation delays. More important, the standby support is viewed as insufficient by the financial markets. In short, this tool does not provide the support necessary.

That leaves the energy loan guarantee program as a critical factor in corporate decisions to proceed with new nuclear projects, and in facilitating construction financing and access to capital. For this reason, the implementing regulations for the loan guarantee program must provide a solid basis for financing.

A properly structured loan guarantee program would allow companies to employ project financing on a non-recourse basis. The ability to use non-recourse project finance structures offsets one of the most significant financing challenges facing new nuclear power plant construction – the cost of these projects relative to the size, market value and financing capability of companies that will build them. New nuclear projects are \$5-6 billion undertakings. Although \$5-6 billion projects are not unique in the energy business, such projects are typically built by major oil companies with market values many times larger than the largest electric companies.

Project financing, supported by loan guarantees, also allows a more efficient, leveraged capital structure, which reduces the weighted average cost of capital and thus provides a substantial consumer benefit in the form of lower electricity prices.

Loan guarantees also mitigate the impact on the balance sheet of these large capital projects which would otherwise place stress on credit quality and bond ratings.

Loan guarantees are important to new nuclear plant financing for both unregulated and regulated companies.

Unregulated generating companies will be hard-pressed to build nuclear power plants and other large capital-intensive baseload projects except on a project finance basis with the debt financing secured by the federal government. Unregulated companies simply do not have the capacity to finance these projects on balance sheet without access to project finance structures. Many regulated electric companies, especially those pursuing multiple generating and transmission projects at the same time, may also be limited in their ability to finance projects without project finance capability because of substantial pressure on credit quality and debt ratings.

Several states – including Florida, Virginia, Louisiana, South Carolina – have passed new legislation or implemented regulations encouraging companies to develop new nuclear projects by attempting to provide greater assurance of cost recovery. Even for many of these companies – still subject to cost-of-service regulation, with supportive state policies – the loan guarantee program is critical to avoid shifting the risks associated with new nuclear plants to end-use consumers.

The scale of these nuclear projects is so large that the first plants will require sharing of risk among shareholders, lenders, consumers and the federal government through the loan guarantee program.

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In the absence of a workable loan guarantee program, the sustained new nuclear construction program necessary to meet U.S. energy and environmental goals will not occur. Since the passage of the Energy Policy Act of 2005, which espoused support for new nuclear construction, the nation's energy and environmental challenges have only increased.

In addition, until the first new plants navigate the Nuclear Regulatory Commission's new licensing process without impact on schedule or cost, the capital markets may not finance new nuclear projects in the absence of a federal loan guarantee. As a group of five major investment banks told Energy Secretary Samuel Bodman in a March 7 letter: "We believe new nuclear construction projects will not have access to the credit markets in order to finance such projects during construction and initial operations without the support of a federal government loan guarantee."<sup>9</sup>

By allowing projects to overcome the market barriers described above, the loan guarantee program is designed to stimulate investment in high-capital-cost projects that are in the nation's best interest because they improve U.S. energy security, meet growing electricity demand, reduce emissions, accelerate the commercialization of improved technologies, and ensure the reliable operation of the electricity system.

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<sup>9</sup> See Appendix I for the complete text of the bankers' letter.

## II. Major Areas of Concern

### A. Financing Structure: The proposed rule has, at its center, a financing structure that is not workable, creating a hybrid loan facility for which there is no market.

By (1) limiting the guarantee coverage to 90 percent, (2) prohibiting *pari passu* security structures, and (3) requiring that the guaranteed portion and the non-guaranteed portion of the debt instrument be sold on a pro rata basis (the prohibition on stripping), the proposed rule attempts to create, through “command and control” regulations, a hybrid financing instrument for which there is no market.

In the case of new nuclear plants, the proposed financing structure is unworkable. Rather than balancing the twin goals -- issuing loan guarantees to encourage commercial deployment of innovative technologies while limiting the financial exposure of the federal government -- the proposed structure will not support the financing of new nuclear plants in the United States and thereby will fail to achieve the statutory goals.

The capital markets are highly efficient at matching investors, risks and rewards. Secure investments, such as U.S. government obligations, find a natural market among those investors who assign a premium to security and accept a lower reward. Higher-risk investments go to those investors willing to accept risk in exchange for an appropriate reward. Any program that attempts to combine higher-risk, non-guaranteed loans with more secure, lower-risk government-guaranteed debt does not recognize the capital market’s ability to match investors’ requirements with the appropriate debt instruments. The risk-averse investor is forced to take risk; those with an appetite for more risk are forced to buy low-yield guaranteed paper. In addition, these two markets also differ dramatically in depth and liquidity, as the charts on the following page illustrate. The market for “agency paper” in 2006 was approximately \$350 billion. The project finance market -- which represents higher-risk, non-recourse debt -- was approximately \$2.5 billion. These two sectors of the capital markets are worlds apart and a federal government regulation cannot force them together, and should not seek to do so.

Based on the discussion in the NOPR and the August 2006 Guidelines, NEI understands that the mandated financing structure -- requiring unguaranteed, subordinated debt -- is designed to ensure that private lenders bear some of the financial risk of these projects. According to this logic, requiring private lenders to have a substantial stake in full repayment -- to have “skin in the game” -- will help to ensure repayment of the guaranteed obligations and will ensure that the capital markets bring independent due diligence and discipline to the financing process.

While we fully support the goals of ensuring that projects that receive loan guarantees be rigorously evaluated and meet the statutory requirement of a “reasonable prospect of repayment,” NEI can find no basis for DOE to set an arbitrary limit on loan coverage levels that effectively prevents projects from achieving the full level of loan guarantee coverage authorized in Title XVII.<sup>10</sup> The basis for the NOPR requirement is an OMB guideline that has been in place for over 20 years with no empirical evidence to

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<sup>10</sup> While it may be theoretically possible to achieve the statutorily permitted level of guarantee coverage of 80 percent of project costs with a 90 percent guarantee, this would require obtaining a larger loan (equal to 88.88 percent of project costs) and result in a debt-to-equity ratio outside standard commercial practice. We do not believe that this is either prudent or likely to be approved by DOE and therefore consider this to be illusory at best.

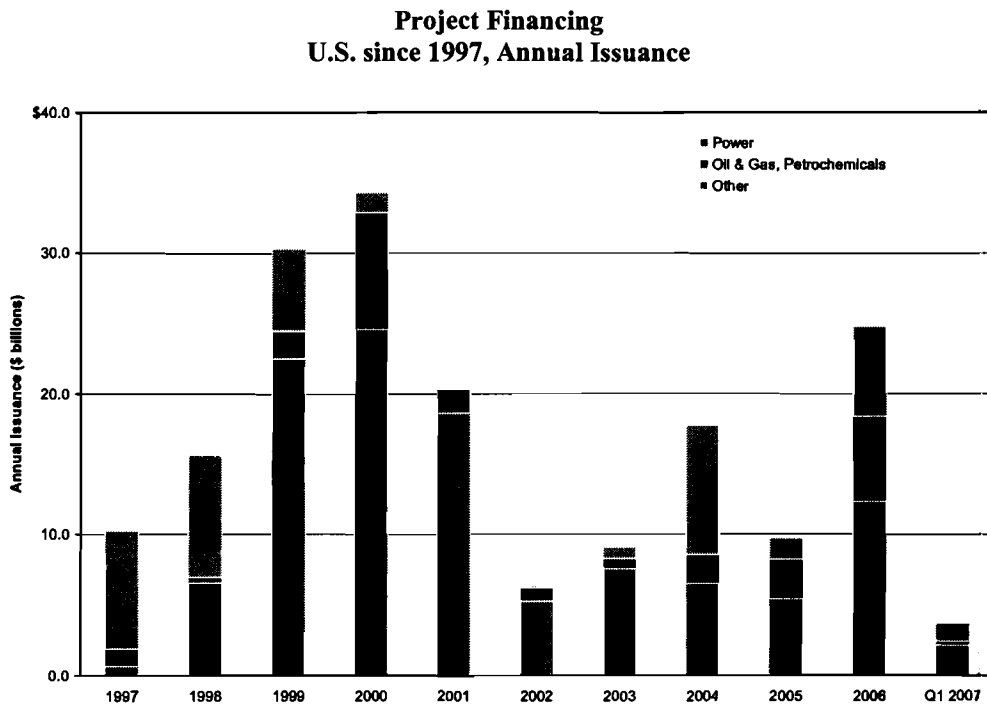
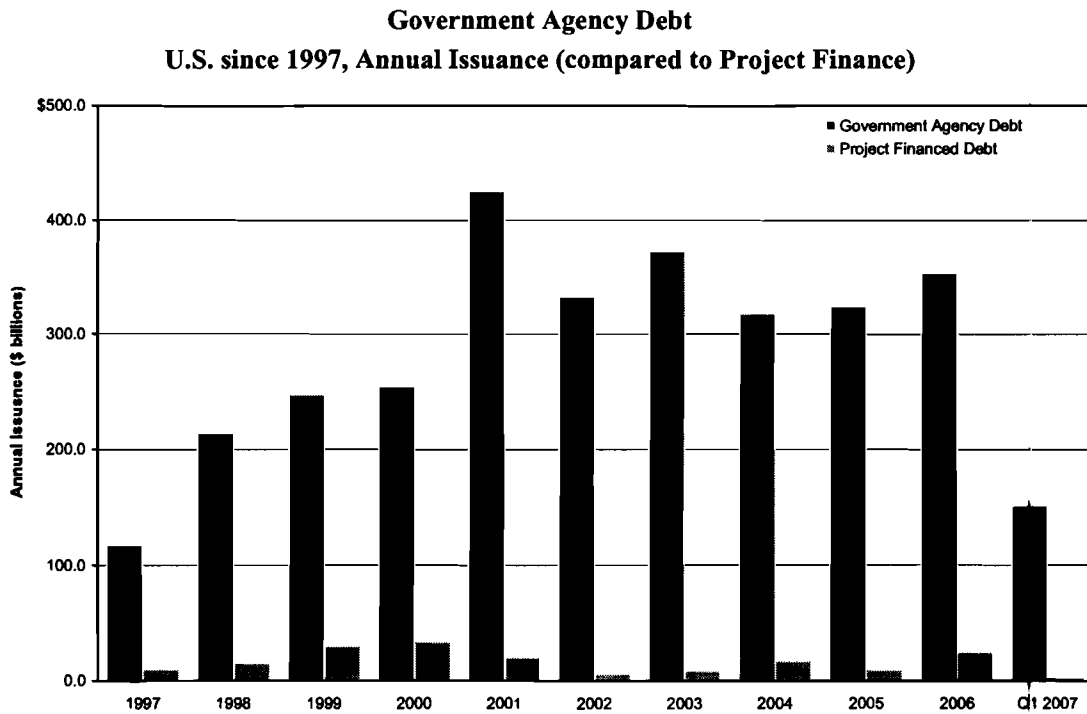


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Source: Securities Data Corporation, Securities Industry and Financial Markets Association

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support its premise.<sup>11</sup> Notwithstanding this OMB guideline on less than 100 percent loan coverage, a number of federal loan guarantee programs, notably the Export-Import Bank and the Overseas Private Investment Corporation, among others, provide 100 percent loan guarantees in support of non-recourse project financings across a broad spectrum of technologies, sectors and countries and have done so successfully with limited project defaults and effectively on a self-sustaining basis.<sup>12</sup> For energy projects alone, over the past 10 years, Ex-Im Bank issued a total of 110 loan guarantee commitments, with a total guarantee value of \$12.7 billion. The portfolio of energy loan guarantees constitutes about 20 percent of the total Ex-Im Bank portfolio.

The keys to the success of these other government loan guarantee programs, which are equally applicable to DOE's loan guarantee program, include:

- Robust credit analysis and underwriting founded on risk-based evaluation criteria;<sup>13</sup>
- Retention of expert outside financial, technical and legal advisors (whose fees and expenses are paid by sponsors or project companies) to assist in the due diligence, underwriting, negotiation, documentation, and monitoring of the projects; and
- Working with experienced, reliable and committed project participants, including sponsors, lenders, construction contractors and off-take counterparties.

This approach, combining rigorous credit analysis based on established evaluation criteria with outside expertise, will ensure that adequate diligence is performed and that such diligence is performed by or on behalf of DOE. In issuing loan guarantees backed by the full faith and credit of the federal government, DOE will be exercising an inherently governmental function, and that function, including the obligation to perform the requisite due diligence, is non-delegable.

Such evaluation criteria and due diligence will supplement the due diligence and project development and implementation that the project sponsors or their representatives will undertake. In the case of new nuclear power projects, the nuclear industry believes that project sponsors – with significant equity (in the range of \$1 billion or more per project) at risk in a first-loss position – are in the best position, and will have the greatest incentive, to ensure that projects are properly developed, constructed, operated and maintained to achieve commercial success. The federal government's interest and the project sponsor's interest are completely aligned.

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<sup>11</sup> See, for example, OMB Circular No. A-70, dated August 24, 1984 (since rescinded), with guidance on loan coverage that has been continued essentially verbatim in current OMB Circular No. A-129.

<sup>12</sup> For example, the most recent OMB assessment of the ExIm Bank loan guarantee portfolio concluded that over the past 5 years the ExIm long-term loan guarantee program achieved over \$30 billion of authorizations with an average default rate of 3%. The ExIm Bank achieved \$18 of export value for every \$1 in appropriations costs ([www.whitehouse.gov/omb/expectmore](http://www.whitehouse.gov/omb/expectmore)). The President's FY 2008 Budget proposes to have Ex-Im Bank operate on a self-sustaining basis, relying on fees collected from borrowers. The President's Budget estimates that the Bank's export credit support will total \$18.7 billion in FY2008, that it will collect an estimated \$146 million in receipts in excess of expected losses and that this amount will be utilized to cover estimated costs on transactions where fees are insufficient to cover expected losses and to cover the agency's administrative costs.

<sup>13</sup> In an assessment of the 2006 Guidelines provided to DOE in January 2007, NEI provided an illustrative set of project risk evaluation criteria. They are included here as Appendix IV.

1. **Percentage Cover: Restricting the loan guarantee coverage to 90 percent of the debt has no basis in law and is inconsistent with other successful federal loan guarantee programs that provide for 100 percent coverage.**

The proposed rule provides that the loan guarantee is limited to no more than 90 percent of the total face value of loans or other debt obligations (§609.10(d)(3)). In its discussion in the NOPR, DOE makes it clear that this 90 percent limitation is to be applied to each particular debt instrument or loan obligation for a project and, as discussed below, prohibits the “stripping” of the guaranteed portion of the debt so as to prohibit the creation of a 100 percent federally guaranteed instrument.

There is no basis in law or administrative practice<sup>14</sup> for restricting the guarantee to 90 percent of project debt. Title XVII authorizes the Secretary of Energy to guarantee up to 80 percent of the project costs and, subject to this limit tied to percentage of total project cost, does not limit the percentage of the project debt that can be covered by the guarantee. The NOPR establishes an across-the-board administrative limitation that would effectively prevent any project from achieving the full amount authorized in the Energy Policy Act. In light of the Administration’s proposal to limit the percentage coverage under Title XVII, members of Congress (in subsequent communications and in proposed legislation) have made clear that Congressional intent contemplated 100 percent loan coverage.

Other successful federal guarantee programs permit 100 percent coverage. In fact, 100 percent loan coverage is the rule rather than the exception in federal loan guarantee programs. The President’s proposed budget for the 2008 fiscal year proposes approximately \$289 billion in new loan guarantee commitments. Excluding the \$9 billion proposed for Title XVII guarantees, 78 percent (\$217 billion of \$280 billion) of all other federal loan guarantees provide for 95-100 percent loan coverage. (See summary data, next page. More detail on these programs, listing their dollar volume and percentage coverage, is provided in Appendix III.) These programs ensure that there is a reasonable prospect of repayment of the underlying loan

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<sup>14</sup> The policy limiting coverage under federal loan guarantees to a percentage of the loan amount is an administrative guideline, not a statutory requirement. This policy long predates the Federal Credit Reform Act of 1990 and allows for a wide degree of flexibility in its application. The Federal Credit Reform Act of 1990 does not address the issue of percentage loan coverage for federal loan guarantees. The Act addresses credit budget management practices. There is no mention in the statute of risk-sharing or any other concept that could be interpreted as support for a policy of less than 100% debt coverage. The OMB policy on 80% debt coverage is an administrative policy that can be traced back to OMB Circular No. A-70, *Federal Credit Policy*, issued in 1984, and perhaps even earlier. Current OMB policy is contained in Circular No. A-129 (Revised), *Policies for Federal Credit Programs and Non-Tax Receivables*, issued in November 2000 (the successor to OMB Circular No. A-70). OMB Circular A-129 (Part II, Section 3a) states that “[p]rivate lenders who extend credit that is guaranteed by the Government *should* bear at least 20% of the loss from a default” (emphasis added). Thus, the policy is not mandatory but suggestive in nature. Circular A-129 also provides flexibility in the application of the guideline on 80% loan coverage. It states: “The policies and standards of this Circular do not apply when they are statutorily prohibited or are *inconsistent with statutory requirements*” (emphasis added). The guideline for 80% coverage of debt is inconsistent with the requirement in EPCA Section 1702 (c), which authorizes that “a guarantee by the Secretary shall not exceed an amount equal to 80% of the project cost.” The application of Circular No. A-129 would effectively prevent the Secretary from ever reaching the statutory cap. Administrative practice in other federal loan guarantee programs also allows for flexibility in setting loan guarantee limits up to statutory caps.

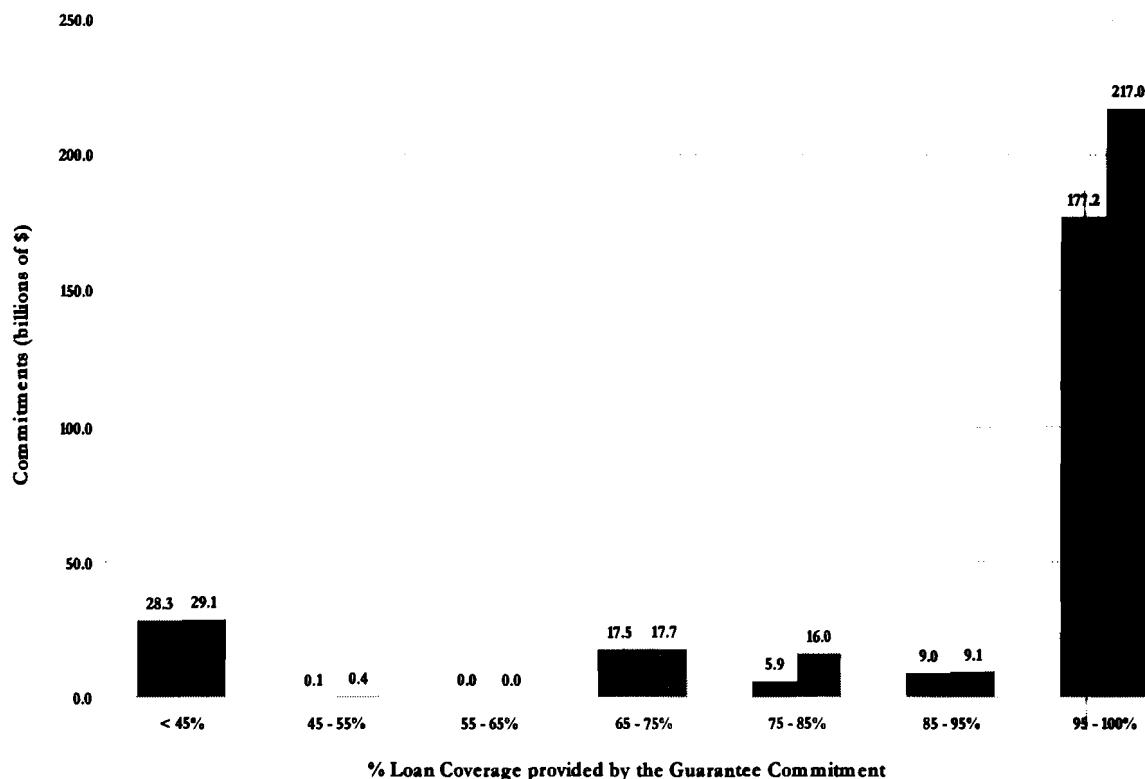
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**% Loan Coverage for Loan Guarantee Commitments  
In the President's FY 2008 Budget (Government-wide Data)**



**% Loan Coverage provided by the Guarantee Commitment**

1. % Loan Coverage represents the percentage of debt financing that is covered by the loan guarantee commitment.

2. Includes data for 54 loan guarantee programs in FY 2007 and 49 loan guarantee programs in FY 2008 for which data was available.

3. Total Government-wide commitment levels are \$238B in FY 2007 and \$289B in FY 2008, excluding SBA Secondary Market Guarantees and GNMA Mortgage-Backed Security Guarantee programs.

Source: EOP Group from budget documents

■ 2007 COMMITMENTS

■ 2008 COMMITMENTS

Coverage Level Range	2007 Commitments	2008 Commitments
95 - 100%	177.2	217
85 - 95%	9.0	9.1
75 - 85%	5.9	16.0
65 - 75%	17.5	17.7
55 - 65%	0.0	0.0
45 - 55%	0.1	0.4
< 45%%	28.3	29.10
<b>Total</b>	<b>\$238 billion</b>	<b>\$289 billion</b>

obligation and that the financial risk to the federal government is limited through careful structuring and underwriting of the project, supported by outside financial, technical and legal advisors paid for by the sponsor or project company as necessary.

One-hundred-percent loan coverage is essential to support the financing for the first wave of new nuclear projects in the United States in order to address the market failure or financing gap that currently exists in the commercial markets. This market financing gap results from the combination of a number of factors, including: (1) the legacy of the previous nuclear plant construction cycle during the 1970s and 1980s, when the two-step licensing process resulted in major cost overruns and delays, (2) uncertainty regarding the new and untested licensing process, and (3) the scale of these projects compared to the size, market value and financing capability of the project sponsors. Without 100 percent coverage under the Title XVII loan guarantee program, the capital markets are unwilling, now and for the foreseeable future, to provide on commercially viable terms the financing necessary to support the level of new nuclear plant construction required to meet our nation's energy and environmental goals.

If it is necessary to reduce the scope or term of the federal government's exposure, the nuclear energy industry believes there are other, more workable mechanisms to do so, without trying to force a tranche of unguaranteed debt into a project's capital structure. For example, DOE and the project sponsor could negotiate a shorter-term tenor for the guaranteed loan – construction plus the first 5-10 years of commercial operation, for example, rather than the maximum term allowed by the statute (30 years of commercial operation or 90 percent of project life).

2. ***Pari Passu*: The prohibition on *pari passu* security structures is contrary to standard lending practice in both the private and public sectors, significantly erodes the ability to attract commercial financing for projects, and increases the risk of project default.**

The proposed rule prohibits *pari passu* security structures. The proposed rule requires that DOE have a first lien position on all assets of the project and all additional collateral pledged as security for the guaranteed obligations and other project debt (§609.10(d)(13) (emphasis added)). Upon payment under the guarantee, DOE shall be subrogated to the rights of the holders and shall have superior rights in and to the property acquired from the holders (§609.15(g)). Recoveries shall be applied first to full payment of the government (including its collection expenses and any other lawful claims of the government) (§609.15(k)).

DOE has interpreted the "superior rights" provision in Title XVII as prohibiting *pari passu* financing structures and is requiring that lenders be fully subordinated with respect to all collateral on the non-guaranteed portion of the debt. This renders the non-guaranteed portion effectively "quasi-equity." Combined with the requirement to sell pro rata (no stripping), this creates a hybrid instrument that has no natural market.

DOE's interpretation is inconsistent with the statutory provision on subordination in Title XVII that permits *pari passu* financing. It is also inconsistent for the government to prohibit 100 percent guarantee coverage but to require superior rights on 100 percent of the collateral. In both the commercial market and in projects involving other federal loan guarantees, it is typical to have other tranches of non-guaranteed debt that are *pari passu* in terms of both payment and

security. Permitting *pari passu* financing could actually increase project creditworthiness and would be in the government's interest.

The requirement in the proposed rule that any commercial debt must be subordinate to the guaranteed debt will significantly restrict the interest of commercial lenders and the availability of financing for the program, especially in view of the size of the projects. By making this program less attractive to top-tier lenders and effectively requiring more expensive sub-debt financing structures, the financeability of a project is significantly compromised. Furthermore, the proposed rule prohibits the substitution of additional equity for the unguaranteed portion of debt. As a result, this restriction could actually erode a project's creditworthiness, rather than enhancing the credit structure.

A simple analogy may best illustrate the lack of rational basis for the position in the proposed rule. If the collateral rights are represented by a pie chart, the senior secured party financing a portion of the pie would be expected to have rights equal to that portion of the pie. If DOE finances 50 percent of the pie, DOE would have rights to one-half the pie. The superior rights provision simply insures that DOE's rights in that half of the pie must be superior to the rights of any other person. It does not provide that, if DOE financed one-half the pie, it must have superior rights to the whole pie. Moreover, the proposed rule goes even further: Not only does it propose that DOE have superior rights in the whole pie but also, if there is another pie (serving as collateral for other project debt or another piece of the financing), DOE must have superior rights in that pie as well.

In the world of complex project finance, there is one bundle of rights (it is difficult to divide a plant or a power purchase agreement, but certainly easy enough to divide up the revenue stream or the proceeds of collateral) and the senior lenders hold undivided interests in that bundle of rights through a Collateral Agent. Invariably, their respective rights are addressed through intercreditor arrangements, and there is nothing in such a structure that is inconsistent with the superior rights provision. At the end, DOE's interest in its portion of the bundle of rights is superior to those of anyone else. So, for example, if the project is sold following default and foreclosure and DOE has guaranteed 90 percent of the debt, it would receive 90 percent of the proceeds and its interest in that 90 percent would be superior to those of any other party.

DOE has misinterpreted the "superior rights" provision (Sec. 1702(g)(2)(B)) as prohibiting *pari passu* financing structures and prohibiting any holders of non-guaranteed debt from recovering on their debt until DOE's claim is paid in full. Section 1702(d)(2), which provides that the obligation guaranteed by DOE cannot be subordinate to other financing, clearly permits *pari passu* financing (where senior lenders share equally and ratably in right of payment and in the security in proportion to their debt). DOE's interpretation is not only contrary to this statutory structure, it is inconsistent with prior DOE regulations and case law interpreting identical language.<sup>15</sup>

The interpretation in the Proposed Rule is also contrary to standard lending practice.

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<sup>15</sup> See Appendix V for a detailed analysis of prior DOE regulations and case law involving *pari passu* financing structures.

If DOE will not guarantee 100 percent of the debt, a standard project financing would be structured so that the senior lenders (both guaranteed and unguaranteed) have a *pari passu* first lien on all project collateral. This first lien would be superior to the rights of other third parties and DOE could, in the case of a payment default, step into the rights of the guaranteed senior lenders through subrogation in proportion to their interests. DOE has interpreted the statute to prohibit this standard structure. In conjunction with its restriction limiting guarantees to 90 percent of the debt and its application of that restriction to “a particular debt instrument,” the result is an anomalous situation where the lenders are guaranteed on 90 percent of the loan and deeply subordinated on the other 10 percent. In the case of a nuclear power plant, 10 percent of the debt is no small sum – for example, on a \$5 billion project with an 80/20 debt-to-equity ratio, 10 percent of the debt instrument would be \$400 million.

To the best of our knowledge, there is no market for the type of subordinated debt envisioned by the proposed rule. Normally, two different types of financial institutions and two different debt instruments would be required for a structure involving sub-debt: One type of institution would invest in the senior, government-backed debt; a different investor (seeking higher rewards in exchange for taking greater risk) would hold the junior debt. Many of the first-tier commercial lenders and other financial institutions (e.g., insurance companies) do not provide, or are restricted in, their ability to invest in subordinated debt. Even where these disparate investments could be placed with a single large institution, the two tranches of debt would be held in separate legal entities (which also appears to be precluded by the proposed rule). The only way to implement the proposed rule’s proposal would be through the use of complex trust arrangements with unnecessary transaction costs, and such mechanisms would serve no useful purpose other than to circumvent DOE’s rule and limit liquidity in the market for holding this debt.

The prohibition on *pari passu* financing will act as a barrier to potential sources of non-equity financing that may be available under the right conditions to innovative technology projects and to the development of commercial financing sources in the future. For example, projects may seek vendor financing to acquire long-lead time equipment prior to applying for and obtaining a Title XVII loan guarantee. It is inconceivable that a vendor providing such financing would then subordinate its prior lien on that asset, or subordinate any other collateral, guarantees or credit support it had obtained to the subsequent DOE-guaranteed financing.<sup>16</sup> As a result, the DOE-guaranteed financing would have to take out that vendor financing, resulting in potentially greater federal exposure than if collateral sharing was permitted. Similarly, the United States-Japan Joint Nuclear Energy Action Plan, announced in April 2007, contemplates future Japanese Government-supported financial facilities, such as trade insurance or other export credits, to support new nuclear plant construction in the United States. However, it is unlikely that the Japanese Government or the official export credit agency of any other country would provide such financing on a subordinate basis. Also, as noted above, the proposed rule

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<sup>16</sup> That such collateral sharing would be statutorily permitted under the “superior rights” provision is evidenced by the prior DOE regulations implementing the virtually identical “superior rights” language in the 1978 legislation. Those regulations clearly acknowledged the possibility that project collateral security might be subject to prior liens granted to the other creditors, and allowed that these liens might continue subject to “an acceptable arrangement” to protect DOE, whereby the creditor would agree, *inter alia*, to “[a] plan of liquidation offering mutual protection for DOE and other creditors.” 10 C.F.R. § 796.11(a)(9) (45 Fed. Reg. 15478 (1980) (removed 60 Fed. Reg. 49196 (1995))) In other words, both DOE and the prior creditors would get “equal” or *pari passu* treatment.

would preclude substitution of sponsor equity for this portion of the project capital structure (e.g., a 25-30% equity with a 70-75% federal government guaranteed debt structure would be precluded). Accordingly, the prescriptive approach limits the ability of sponsors and their financial advisors to propose creditworthy financing structures that may provide less government exposure.

Moreover, even if the "superior rights" provision is interpreted to preclude sharing of first lien priority status, it should not require the level of subordination set forth in the guidelines, which goes well beyond standard practice for second lien and mezzanine financing. These restrictions will force the unguaranteed debt to be sub-debt that is quasi-equity. Such sub-debt would be very expensive, if available at all.

In addition, the final regulations should clarify that the holders of the guaranteed obligations are secured by the first priority liens until payment on the guarantee, at which point DOE shall be subrogated to those rights.

**3. Pro Rata Syndication/No Stripping: The requirement for pro-rata sales and the prohibition on "stripping," which have no statutory basis, further limit the attractiveness of this program for potential lenders and constrain the availability of financing for eligible projects.**

The proposed rule provides that the guaranteed portion of debt may not be sold separately as an instrument fully guaranteed by the federal government (§609.10(d)(4)). The NOPR requires that the guaranteed portion and the non-guaranteed portion of the debt instrument be sold on a pro-rata basis in connection with the participation, syndication or other sale in the secondary market.

The market for federally guaranteed paper is distinct from and involves different investors than the market for deeply subordinated/quasi-equity debt. Requiring pro rata sales of a hybrid instrument is not workable. This provision also needlessly increases costs and reduces liquidity by eliminating the banks' ability to utilize their securitization or conduit vehicles, which are an efficient mechanism to fund these loans.

A number of the top-tier lenders that participate in federal loan guarantee programs use securitization or conduit vehicles as a mechanism to reduce costs and improve liquidity. Given the size of the projects, no single lender could finance the project; it is, therefore, critical to ensure maximum possible liquidity by having access to multiple sources of capital. In effect, these lenders fund their loans by transferring the loans to special-purpose vehicles that hold only 100 percent federally guaranteed instruments, then sell interests in those vehicles. They have found that these vehicles are an efficient mechanism to fund these loans and are necessary because of the very thin spreads and limited profitability of federally guaranteed loan programs. The proposed rule would make these securitization or conduit vehicles, which are used in other federal programs, unavailable for this program. If lenders cannot use their securitization vehicles, they may not participate in the program. This achieves the anomalous result that those lenders with the most federal loan guarantee experience would opt out.

As already discussed above, the pro-rata secondary sale prohibition also ignores the commercial reality that the A loan (senior debt) and B loan (sub-debt) market are distinctly



different and involve different investors. Combining the no *pari passu* restriction and the prohibition on stripping will make such loans very difficult, if not impossible, to syndicate and thereby further restrict the availability of financing for this program.

The prohibition on stripping, in tandem with the requirement for only a partial guarantee (i.e., less than 100 percent loan coverage) appear to be intended to encourage a rigorous evaluation of the project creditworthiness by commercial lenders. However, the prohibition on stripping is a very poor proxy requirement for assessing project creditworthiness because the feasibility of the "hybrid" credit instrument is limited by the lack of a market for such instruments, as described above. The restrictions on achieving a 100 percent guaranteed instrument, combined with the prohibition on *pari passu* security structures, render the loan guarantee program unusable for new nuclear power plants. Moreover, allowing stripping alone would not lead to a viable loan guarantee program. Rather than such mechanisms, DOE should focus on assessing the financial strength of the underlying project.

## **B. Subsidy Cost**

- 1. Calculation: The loan guarantee program should provide a transparent methodology for calculating the subsidy cost, and such costs should be reasonable and commercially viable (in line with those of other federal loan guarantee programs).**

The proposed rule contains no discussion or guidance regarding the method for calculating or the amount of subsidy cost. The Proposed Rule only provides that, on or prior to closing date, OMB must review and approve DOE's calculation of the subsidy cost (§609.9(d)(3)).

Project sponsors need a reasonably accurate estimate of the subsidy cost early in the development process in order to support multi-billion-dollar investment decisions. The proposed rule provides no methodology for determining the subsidy cost and administrative fees for the guarantee, making the value of the guarantee difficult to determine in advance. Given the extended, multi-step negotiation process required for the award of a guarantee, a significant commitment of time and development funds will be required, and the project schedule and cost may be adversely impacted, if a mutually acceptable subsidy cost is not easily determined early in the process. For regulated electric companies, negotiation with state regulatory bodies concerning recovery of project costs will be impossible without some reasonable estimate of subsidy cost. Other federal loan guarantee programs (e.g., Ex-Irn Bank, OPIC) are comparatively more transparent.

The final rule should clarify that, when determining subsidy costs, DOE and OMB will evaluate the entire risk profile of the project, including (but not limited to):

- Creditworthiness of the project and, to the extent of the equity contribution, the project sponsor based upon, among other things, the credit rating, if any, of the project sponsor, and other quantitative and qualitative factors such as profitability, liquidity, capital structure, cash flow, strength of off-take arrangements, default recovery analysis, and management and operator experience;
- Borrower's exposure to market and commodity risks;
- Borrower's exposure to vendor cost increases or construction delays.

Clearly, the more creditworthy the project, the lower the subsidy cost should be. The final regulations should recognize that greater equity investment, liquidity and management experience reduce default risk and, therefore, should result in lower subsidy cost.<sup>17</sup>

The nuclear industry believes that it is critical that DOE, with full opportunity for stakeholder comment and input, establish promptly a transparent methodology for calculating the subsidy cost. This is necessary to provide the level of certainty and predictability necessary for companies, their boards and the financial community to make timely investment and financing decisions for these multi-billion-dollar projects. Established federal loan guarantee programs (such as Ex-Im Bank and OPIC) can inform this process, and credit rating agencies have published guidance on calculation of capital charges for financial guarantee insurance that may be useful.

Developing an acceptable methodology for calculating credit subsidy cost is a matter of some urgency. The nuclear industry sees no need for another extended rulemaking process to develop that methodology, given the tools already available to analyze project risk in the private sector and in other federal loan guarantee programs. NEI suggests that DOE develop written guidance as to the specific considerations that will enter into the determination of the credit subsidy cost for a project and modify the proposed rule to: (1) provide for early disclosure to an applicant of how DOE expects to apply those considerations in determining the credit subsidy cost for the applicant's project; and (2) afford the applicant an opportunity to respond in writing for the purpose of allowing DOE to determine whether additional considerations and analysis warrant a re-estimation.

2. **Exclusion from project cost: Borrower-paid subsidy costs (and fees paid for administrative costs) are financing costs incurred by the project and should be included in project costs, consistent with standard practice in commercial project finance and in other federal loan guarantee programs.**

The proposed rule excludes subsidy cost (as well as administrative fees) from project costs (§609.12(c)(7)).

These costs are financing costs incurred and expended by the sponsors and should be included in project cost. These exclusions are inconsistent with the treatment of similar costs in commercial project financing and in other federal programs. For example, the exposure fee charged by Ex-Im Bank is not only counted as a project cost, but borrowers can elect to have that cost financed under the Ex-Im Bank loan or loan guarantee. We understand that other federal loan guarantee programs, including the USDA Facilities loan guarantee program, the USDA Business and Industry Loan Guarantee Program, the SBA 7a loan guarantee program and the Maritime Administration Title XI loan guarantee program, follow similar practices. For example, MARAD explicitly allows loan guarantee fees to be included in the loan guarantee financing package, but excludes administrative fees.<sup>18</sup> The USDA Business and Industry Loan Guarantee Program allows the USDA loan guarantee fees to be included in the

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<sup>17</sup> See Appendix IV for an illustrative set of project risk evaluation criteria that could be utilized in determining subsidy cost.

<sup>18</sup> See 46 CFR 298.21.

loan guarantee financing package, while private lender fees, such as packaging fees, are eligible project costs but must be financed from equity contributions.<sup>19</sup>

In addition, there is no provision in either the Federal Credit Reform Act or OMB Circular No. A-129 that prohibits the inclusion of fees in the financing package. The inclusion of such fees in the financing package does not increase project risk, nor does it diminish the reasonable prospect of repayment of the loan.

We believe Congress intended that the Title XVII program be implemented in a manner consistent with the experience in other federal loan guarantee programs unless expressly specified.

### **3. OMB Approval of Credit Subsidy Cost**

In Section 609.9(d)(3) ("Closing on the Loan Guarantee Agreement"), the proposed rule requires that OMB must have reviewed and approved DOE's calculation of the credit subsidy cost of the loan guarantee. This may be justified for federal loan guarantee programs where the cost of the loan guarantee is paid from appropriated funds. In such cases, the administering agency must make a request to OMB for appropriations, which is then incorporated into the President's budget request to Congress. Thus, OMB must approve the total budget subsidy cost for the entire portfolio of projects that will receive loan guarantees. That model does not apply here. The NOPR provides that Title XVII is a self-pay program, where all administrative expenses as well as the credit subsidy cost is to be paid by the project applicant. Under those circumstances, we question why the DOE calculation of the credit subsidy cost must be approved by OMB, and why this approval needs to be on a project-by-project basis. We believe that OMB can conduct its oversight under the Federal Credit Reform Act by reviewing the credit subsidy cost for the total portfolio of projects or by reviewing estimates for categories of technologies.

### **C. Requiring annual authorization in appropriations acts does not provide the level of certainty required to support investment in new nuclear power plants.**

The Proposed Rule provides that DOE must have received authority in an appropriations act prior to entering into a guarantee (§609.9(c)(1)).

DOE's interpretation is inconsistent with the conclusion reached by the Government Accountability Office.<sup>20</sup> Since this program will operate as a self-pay program that has been authorized by statute, the program does not require a volume limitation in an annual appropriations act. Subjecting the program to unnecessary volume limits and the annual appropriations process will not provide the certainty

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<sup>19</sup> See 7 CFR 1980.411 (a)(12) and (a)(13).

<sup>20</sup> Annual loan volume limitations are not necessary in the case of the energy loan guarantee program authorized by Title XVII, because the project sponsor is expected to pay the credit subsidy cost associated with the loan guarantee. This interpretation was confirmed by the Government Accountability Office (GAO), in an April 20, 2007, letter report to the House Appropriations Committee's Subcommittee on Energy and Water Development. In that assessment, GAO concluded: "To read section 1702(b)(2) as subjecting Title XVII loan guarantees to the requirements of FCRA would read subsection 1702(b) out of the law, and we cannot do that; we have to give meaning to all of the enacted language." GAO also found that section 1702(b)(2) "confers upon DOE independent authority to make loan guarantees, notwithstanding the FCRA requirements."

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necessary to support investment and financing decisions for new nuclear power development in the U.S. The industry is planning multi-year, multi-billion-dollar investments in new projects in the expectation that federal loan guarantees will be available. These multi-year commitments must be matched with a firm multi-year commitment from the federal government.

For planning purposes, DOE may need to make projections of loan guarantee volumes. These should be flexible planning guidelines, rather than targets. DOE is not in a position to assess with precision the market forces that will govern the number of new projects potentially eligible for loan guarantees or the types of technologies that project developers will select.

The practices in other federal loan guarantee programs also may be instructive. As illustrated in the table on the next page, many loan guarantees operate under cumulative authorization levels, without annual limits in appropriations Acts. Annual volume limitations appear to be an appropriate credit management tool in certain programs, such as housing and small business loan guarantee programs, where the programs have extensive statistical histories and large portfolios containing relatively small individual transactions.

The Transportation Infrastructure Finance and Innovation Act (TIFIA) loan guarantee program is an example of a successful federal business model supporting large, multi-year capital projects. This multi-year mutual commitment is acknowledged in the DOT regulations for credit assistance for surface transportation projects as follows: "The TIFIA's effectiveness in stimulating private investment in transportation infrastructure depends, in large part, on the investor recognition that the TIFIA credit instruments represent solid and reliable Federal commitments."<sup>21</sup>

The nuclear industry urges DOE to adopt the GAO opinion that authority in an annual appropriations Act is not required for issuance of a loan guarantee whose credit subsidy cost is paid in full by the project sponsor. If DOE concludes that any further clarification of this interpretation is required, DOE should support legislation to eliminate this requirement. Finally, DOE should develop a program business model that provides certainty to stimulate private investment, adopting successful practices from other federal loan guarantee programs as appropriate.

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<sup>21</sup> See 49 CFR 80.5 for a more complete discussion of the TIFIA multi-year commitment process.

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**Management of Program Levels in other Federal Loan Guarantee Programs****Volume Limitations in Annual Budgets/Appropriations Acts**

	<b>Authorized Program Level</b>	<b>FY 2006 Appropriations Acts</b>	<b>FY 2008 President's Budget Proposal</b>
Transportation Infrastructure Finance and Innovation Program (TIFIA)	None (\$122M annual limit on budget subsidy costs)	None	None
Railroad Rehabilitation and Improvement Program	\$35B limit on cumulative outstanding balance	None	Yes: \$100M
Maritime Administration Title XI Loan Guarantees	\$12B limit on cumulative outstanding balance	No new guarantees assumed	No new guarantees proposed
Overseas Private Investment Corporation (OPIC)	\$29B limit on cumulative outstanding balance	None	None
Export-Import Bank	\$100B limit on cumulative outstanding balance	None	None
AID – Development Credit Authority	None	Yes: \$700M	Yes: \$700M
SBA – Section 7a Small Business Loan Guarantee Program	Annual limits set in authorization acts through FY 2006	Yes: Not to exceed authorization level	Yes: \$17.5B
SBA – Section 503 Small Business Loan Guarantees	Annual limits set in authorization acts through FY 2006	Yes: Not to exceed authorization level	Yes: \$7.5B
SBA – Section 303b Small Business Investment Company (SBIC) Program	Annual limits set in authorization acts through FY 2006	Yes: \$3B	Yes: \$3B
SBA – 5g Guarantees of Trust Certificates (secondary guarantees for pools of SBA 7a loans)		Yes: \$12B	Yes: \$12B
USDA – Renewable Energy Program	None	None	None
USDA – Community Facility Loan Guarantees	None	None	None

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**Volume Limitations in Annual Budgets/Appropriations Acts**

	<b>Authorized Program Level</b>	<b>FY 2006 Appropriations Acts</b>	<b>FY 2008 President's Budget Proposal</b>
USDA – Business and Industry Loan Guarantees	None	None	None
GNMA – Guarantee of mortgage-backed securities	None	Yes: \$200B	Yes: \$200B
FHA – Mutual Mortgage Insurance (MMI)	None	Yes: \$185B	Yes: \$185B
FHA – Other Multifamily and Other Specialized Insurance	None	Yes: \$35B	Yes: \$35B
HUD – Indian Housing Loan Guarantees	None	Yes: \$116M	Yes: \$367M
HUD – Native Hawaiian Loan Guarantee Fund	None	Yes: \$36M	Yes: \$41M

*Source: EOP Group, Inc, compiled from legislative authorizations, appropriations acts and the President's budget documents.*

### **Part III – Additional Issues**

#### **A. Additional Financing Issues**

##### **1. Minimum Equity Percentage**

The proposed rule provides that in evaluating applications, DOE will consider the amount of equity committed to the project (§609.7(b)(7), (§609.10(d)(5)). Applications will be denied if the applicant will not provide a significant equity contribution (§609.7(a)(6)).

DOE should not mandate a specific minimum equity percentage in the final regulations. The appropriate debt/equity ratio will vary across technologies and sectors and among projects, and DOE should not impose inflexible requirements. The appropriate level of equity should be determined by project economics, considered in the credit analysis and underwriting, and reflected in the credit subsidy cost. Consideration of alternative proposals from public power entities with respect to meeting “equity” requirements should recognize the special circumstances associated with such entities. Public power entities do not have investors that contribute “equity.” These entities routinely finance 100 percent of the cost of projects, and DOE should permit such entities to arrange for debt financing to secure funds for the non-guaranteed portion of their project cost.

##### **2. Credit Rating**

The proposed rule requires a project sponsor to obtain, at the application stage, a preliminary credit assessment for the project without a loan guarantee from a nationally recognized rating agency (§609.6(b)(21)). In addition, the applicant must provide not later than 30 days prior to closing, a credit rating from a nationally recognized rating agency reflecting the final term sheet without a federal guarantee (§609.9(f)).

Obtaining a credit assessment for the project without the guarantee is not likely to be useful. Such an assessment would demonstrate why these innovative technologies require loan guarantees to obtain financing. It would be more appropriate to evaluate the creditworthiness of the project taking into account the loan guarantee.

The rating agency requirement represents an unnecessary expenditure of time and funds. To the extent that DOE requires a third-party credit assessment of the project as part of its credit analysis, or in the determination of subsidy cost, project sponsors should not be limited to utilizing one of the rating agencies and should have the ability to obtain the credit assessment from other acceptable independent firms with recognized expertise and standing. An independent analysis of the project by consulting engineer or other reputable firm would provide more relevant information for assessing project viability and risk. In fact, such an analysis would be required by the lenders in order to evaluate the project.

This issue should be addressed as one element in the development of a comprehensive and transparent methodology for determining budget credit subsidy costs.

##### **3. Non-Recourse**

The proposed rule provides that DOE must ensure through the loan guarantee agreement that the borrower has "pledged project assets and other collateral or surety, including non project-related assets, determined by DOE to be necessary to secure the repayment of the Guaranteed Obligations" (§609.10(d)(10)).

DOE should clarify that the program is intended to be structured as non-recourse project financing and that guaranteed loans will require security in only the project assets, contracts and agreements.

The statute makes clear (Section 1702(g)(4)(B)) that, in the event of default, the loan guarantee is non-recourse beyond the project: "If the borrower defaults on an obligation, the Secretary shall notify the Attorney General of the default .... On notification, the Attorney General shall take such action as is appropriate to recover the unpaid principal and interest due from -- (i) such assets of the defaulting borrower as are associated with the obligation; or (ii) any other security pledged to secure the obligation."

This non-recourse provision is essential for successful project finance structures. If the guaranteed loan is recourse beyond the project—e.g., to the balance sheet of a project sponsor—the rating agencies will impute that debt to that project sponsor's balance sheet, and require the company to increase the amount of equity in its capital structure in order to maintain its overall debt rating. This would offset much of the economic benefit of the guarantee.

A project sponsor should, at its discretion, have the flexibility to pledge additional assets or other forms of security as collateral (e.g., to reduce the credit subsidy cost of the loan guarantee), and the regulations should provide this flexibility. Other federal loan guarantee programs allow for sponsors to propose various forms of collateral, with the understanding that the level and quality of collateral will be considered as an evaluation factor in assessing project creditworthiness and determining the level of the loan guarantee fee.

## **B. Eligible Technologies**

### **1. General Use**

The proposed rule proposes two possible ways of interpreting "general use." A technology would be considered to be in general use and therefore not eligible for a loan guarantee if it has been ordered for, installed in, or used in five or more projects in the United States, or has been in operation in a commercial project in the United States for a period of five years, measured from the commissioning date. (§609.2, Definition of "Commercial Technology").

A fixed numerical standard is neither necessary nor workable given the variety of technologies and sectors eligible for loan guarantees. If a fixed standard is adopted, the standard should include both number of projects and number of years of commercial operation. Lenders require both in order to be comfortable that a technology is commercial and can be financed in commercial markets.

The inclusion of "ordered for" or "installed in" (in Alternative 1) is inconsistent with the statutory definition of "in general use in the commercial marketplace" and the test of "in service in the United States." The test consistent with the statutory language should be



“ordered for, installed in, and used in”. In addition, the limitation in Alternative 2 to one project is inconsistent with the concept of “general” use. “In operation in one project throughout the United States” does not meet the plain meaning of the statutory definition which is “in general use in the commercial marketplace.”

**2. New or Significantly Improved**

The proposed rule defines new or significantly improved technology as one that has either “only recently been discovered or learned” or that involves “meaningful and important improvements in the productivity or value of the technology” (§609.2, Definition of “New or Significantly Improved Technology”).

The proposed rule appears to require that the technology be both “new or significantly improved” and not in general use in the commercial marketplace in the United States. This is contrary to the statutory language which provides that the test for new or significantly improved is “as compared to” commercial technologies in service in the U.S. at the time the guarantee is issued. The definitions of “Eligible Project” and “New or Significantly Improved Technology” should be clarified to specify that the technology be new or significantly improved as compared to commercial technologies in service in the U.S. at the time the guarantee is issued.

**C. Definition of Project Cost**

**1. Restriction on General and Administrative Expenses**

The proposed rule (§609.12(c)(2)) excludes from project cost “parent corporation or other affiliated entity’s general and administrative expenses, and non-project related parent corporation or affiliated entity assessments, including organizational expenses.” Although we agree that, in general, the parent corporation or other affiliated entity’s general and administrative expenses should not be included in project costs, the proposed restriction is drawn too broadly. For example, the project sponsor entity may have entered into a contractual service agreement with an affiliate or parent entity. These service agreements provide vital services such as legal and administrative support on a more cost-effective basis than if the project sponsor provided these services on a free-standing basis. These contracts may allow for cost-reimbursement based on a formula that includes a portion of G&A expenses. The costs of such contracts should be allowed as eligible project costs.

**2. Restriction on Research and Development Costs**

The proposed rule (§609.12(c)(5)) excludes from project cost “research, development, and demonstration costs of readying the innovative energy or environmental technology for employment in a commercial project.” The nuclear industry believes that R&D expenses directly related to the project, and that have been capitalized and added to the project costs, should be considered as eligible project costs.

**3. Restriction on Dividends and Profit Sharing**

The proposed rule (§609.12(c) (4 )) excludes from project cost “dividends and profit sharing to stockholders, employees, and officers.” Dividends and profit sharing are normally paid from net

operating cash flows, not from capitalized project costs that are financed with guaranteed debt. If DOE's intent is to restrict the ability of applicants to capitalize such costs in the project cost to be financed, then we agree with this restriction. However, if DOE's intent is to restrict the ability of the applicant to pay such costs from net operating income, then this poses a serious issue. Typically, dividends are paid to equity holders only after debt service has been paid. Therefore, as long as the project's guaranteed debt is being repaid on schedule, DOE has no basis to impose restrictions on the payout of dividends. We also have a concern about the use of the term "profit sharing." Companies may have performance-based executive compensation provisions, and these performance-based systems may use both individual performance measures as well as project-based or company-wide performance measures. We believe that such systems provide strong incentives for good management, including effective cost-control. Restrictions on performance-based compensation systems would be counterproductive to achieving the statutory purpose of reasonable assurance of repayment of the loan. The nuclear industry recommends that this prohibition be re-written as follows: "(c)(4) Planned dividend payments or other payouts to equity holders that are capitalized in costs to be financed, provided that equity payouts and performance-based compensation that are paid from net operating income, after timely payment of principal interest on guaranteed loans, shall not be affected."

#### **4. Restriction on Costs Prior to In-Service Date**

The proposed rule (§609.12(c)(8)) excludes from project cost "expenses incurred after startup, commissioning, and shakedown before the facility has been placed in service." This provision is unclear, confusing and will be difficult to administer. It is very difficult to determine whether any costs fall within this restriction. Normally, project sponsors capitalize all costs for startup, commissioning and shakedown up to the time that the facility is placed in service. It is sometimes possible that sponsors continue to incur such costs after the project has been placed in service but, at that time, the costs are charged to operations, repair and maintenance accounts. The key point is that the distinction among the costs is based on the in-service date rather than the nature of the activity. We recommend that this provision be replaced by a simpler standard as follows: "(c)(8) Any expenses incurred after the facility has been placed in service." We believe that the triggers for determining the in-service date should be specified in the loan and the loan guarantee agreements.

### **D. Lender Issues**

#### **1. Duty of Care**

The proposed rule requires that an eligible lender or other servicer shall exercise "the level of care and diligence that a reasonable and prudent lender would exercise when reviewing, evaluating, disbursing and servicing a loan made by it without a Federal guarantee" including "ensuring" that the collateral package remains uncompromised (§609.11(b)).

It is standard in loan documentation for the agent and other lenders to limit their liability except in the case of gross negligence and willful misconduct (and often only as finally determined by a court). The standard proposed in the NOPR is not conventional and will likely limit the numbers of lenders interested in participating in the program. It is not realistic to expect lenders to assume greater liability, especially in the case of a federal loan guarantee program where profit margins are expected to be very limited. Imposing such a requirement in the final

regulations will further restrict the interest of commercial lenders and the availability of financing for this program.

Ongoing obligations of due diligence and care will effectively result in the guarantee being conditional, which largely undermines the value of the loan guarantee. This also will impede the ability to syndicate the debt and thereby compromise the effective and orderly organization of capital to support the project.

The monitoring and reporting obligations are not consistent with standard practice in capital markets transactions. The regulations also should recognize that it is customary in the syndicated bank market to have certain of the lenders act as agents for the syndicate. The final regulations, therefore, should not impose "Eligible Lender" requirements on all holders.

## **2. Audit**

The proposed rule provides that DOE may from time to time audit any or all items of costs included as project costs and may exclude or reduce the amount which it determines to be unnecessary or excessive or otherwise not to be an item of project costs (§609.17(b)).

After-the-fact audit requirements which could result in reducing the amount of Project Costs and, therefore, the amount of guarantee coverage effectively make the guarantee conditional.

It is customary in project financings to have the independent engineer review and provide certification of costs prior to each loan disbursement during construction. Once a loan disbursement is made pursuant to such procedures, the guarantee of such disbursement should be unconditional and should not be subject to a reduction in a post-disbursement audit.

The regulations establish a broad standard for disallowance of costs, opening the door to the *de facto* imposition of the Federal Acquisition Regulations (FAR). In short, this provision could result in the application of government procurement rules to a privately-financed project, and potentially place at risk any costs that do not conform with the FAR cost principles.

In addition, nuclear generating projects subject to cost of service regulation will have their costs subject to review by state public utility commissions or the Federal Energy Regulatory Commission. In such instances, project costs will be subject to utility cost accounting standards, which provide another level of oversight of the reasonableness of project costs.

These provisions contain a broad assertion of authority by DOE to review and unilaterally decide the eligibility of any cost items it so chooses. We recommend that this provision be deleted.

## **3. Full Faith and Credit and Incontestability**

The proposed rule provides that guarantees issued in accordance with the regulations carry the full faith and credit of the United States. Such guarantee will be conclusive evidence that the guarantee was properly obtained and that the underlying loan qualified. Such guarantee will be presumed to be valid, legal and enforceable but for fraud or material misrepresentation by the holder (§609.14).

## **Comments of Nuclear Energy Institute**

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The exceptions for fraud or material misrepresentation by the holder are not necessary given settled principles of law and other available remedies. However, because these exceptions are well-settled we do not believe this provision will materially affect the unconditional nature of the guarantee, its marketability, or the ability to place the debt in conduit or securitization vehicles (in the event the 100 percent or no stripping provisions are corrected).

### **E. Other Government Assistance**

#### **1. Multiple Forms of Federal Assistance**

The proposed rule provides that DOE will consider whether the project relies on other government assistance and will seek to minimize support for projects that rely on multiple forms of significant federal financial assistance. DOE states its position that it is generally desirable that each project receive only one form of assistance; multiple forms will be a negative factor (Discussion and §609.7(b)(9)).

The proposed rule notes that multiple forms do not disqualify a project, and DOE recognizes that in some situations (e.g., new nuclear generating facilities) multiple forms of assistance could advance important policy priorities.

Utilization of multiple forms of governmental assistance should not be a negative factor. The incentives provided in the Energy Policy Act of 2005, for example, are intended to be complementary and address different elements of project cost and risk. They are not mutually exclusive, and utilization of multiple incentives should enhance a project's creditworthiness. For example, the availability of the production tax credit reduces market risk, and the standby support contract, if properly constructed, reduces force majeure risk.

The subsidy cost model should, therefore, reflect the benefits of multiple incentives (e.g., standby support, tax credits, etc.) and should result in reduced subsidy cost to reflect the reduced risk of default.

#### **2. Tax-Exempt Debt**

The Proposed Rule provides that the loan guarantee may not finance, directly or indirectly, any tax-exempt debt obligation (§609.10(d)(7)).

Tax-exempt treatment of government-guaranteed debt is addressed in the tax code, and it is neither necessary nor appropriate for the loan guarantee program regulations to address this issue.

### **F. Solicitation Process**

The Proposed Rule requires DOE to issue a solicitation to start the loan guarantee process (§609.3(a)), specifies that DOE has the ability to tailor specific solicitations to certain types of projects, and asserts that DOE will not consider unsolicited applications.

The nuclear industry believes that the Title XVII program should be conducted as an open application process and should not be subject to an arbitrary solicitation cycle or other

limitations that may not comport with a project sponsor's project development timetable. Given the size of a loan guarantee for a new nuclear facility and the critical timing elements around the Nuclear Regulatory Commission's licensing process, applicants for loan guarantees for new nuclear plants must have flexibility to submit applications to support the timing of their projects.

Subjecting the program to mandatory solicitation constraints does not provide the certainty necessary to support development and financing of new nuclear power plants in the U.S. DOE is not in a position to assess with precision the market forces that will govern the number of new projects potentially eligible for loan guarantees, or when those projects will need loan guarantees.

Other major federal loan guarantee programs – including TIFIA, Ex-Im Bank and OPIC – operate with an open or ongoing (rolling) application process. In fact, initially the TIFIA program was modeled on the Department of Transportation's (DOT) discretionary grant programs and operated with fixed-date solicitation rounds for fiscal years 1999-2001 before the DOT, based on experience, revised this approach in May 2001 in order to accept applications at any time if the project met the threshold requirements for review.<sup>22</sup> At the time that the TIFIA program regulations were first adopted, the DOT rejected suggestions that DOT establish a rolling application and approval process instead of fixed-date solicitations.<sup>23</sup> Explaining its change to an ongoing application process, the DOT stated that “[u]nder a rolling application process, potential applicants can better time their TIFIA submissions with their project development activities.”<sup>24</sup> DOE should learn from DOT's experience in this regard (rather than repeat its mistake) and should follow the successful approach of the other major loan guarantee programs that utilize an open application process.

## **G. Application Process**

### **1. Cumbersome Multi-Step Process**

The NOPR provides for a five-step process: preliminary application, invitation to submit an application, issuance of a term sheet by DOE, execution of a conditional commitment, and final loan guarantee agreement. DOE may issue solicitations that skip the pre-application stage (§609.3(a)). In addition, the Conditional Commitment is not legally binding on either DOE or the applicant (§609.8(c)).

The process is unnecessarily lengthy and cumbersome. A three-step process should be sufficient: application, conditional commitment, and final loan guarantee agreement. After a preliminary review of the application by DOE, the process should move to the negotiation of the term sheet and issuance of a conditional commitment, culminating in the final loan guarantee agreement. Applicants should have the option of submitting a pre-application if they would like early confirmation of DOE's interest and their eligibility.

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<sup>22</sup> See Transportation Infrastructure Finance and Innovation Act Report to Congress (June 2002), at p. 11.

<sup>23</sup> 64 Fed. Reg. 29744-29745 (June 2, 1999).

<sup>24</sup> 66 Fed. Reg. 27748 (May 18, 2001). “This notice institutes a ‘rolling’ application process replacing the practice of setting fixed application dates.” *Id.* at 27747.

## **2. Application Requirements**

The requirements for a conditional commitment letter from lenders and a commitment of equity are unnecessary at the preliminary application stage, and impose a significant burden on project sponsors at an early stage in project development. The Export-Import Bank has provided Board approval of a preliminary commitment, or even a final commitment, with the guaranteed lender still to be identified.

Lenders will not be willing to provide a commitment letter at early stages in the project without substantial conditions that would render the commitment meaningless. Rather, commitment letters generally are issued at the end of the project development, when the project is ready to be financed and after going to the credit committee at the lending institution. More appropriately, for earlier stages, DOE should accept a mandate letter, which offers a higher level of commitment than a mere expression of interest, but which can customarily be obtained in time to support the application process.

Development of a project's financing plan and negotiation of terms and conditions with commercial financing institutions and potential equity sources should proceed in parallel with negotiation of loan guarantee terms and conditions. The level of project definition, development of a financing plan, equity contributions, etc. required by the proposed rule at the preliminary application stage are more appropriate for the detailed application phase, after an initial review indicates a project is a legitimate candidate for a loan guarantee and when negotiations on the financing term sheet are underway. In addition, many of the proposed rule's requirements at the application stage (e.g., legal opinions, closing checklists) reflect steps that will occur much later in the financing process, in some cases just before closing.

## **H. Other Issues**

### **1. Technology Availability**

Section 609.6(b)(5)(v) of the proposed rule requires each applicant to describe how it "intends to assure the further commercial availability of the technology(ies) in the United States." As drafted, this rule reflects a misconception about the ownership of technology rights.

Many loan guarantee applicants will not own technology related to the project for which it seeks a guarantee, and can do nothing to "assure" the technology will be made available to others. The rule should be redrafted to impose this obligation only on owners of technology used in a guaranteed project. If necessary, DOE could require that an applicant that has no technology ownership rights do nothing to hinder the further commercial deployment in the United States of the technology the applicant may use in a project receiving a loan guarantee.

### **2. Legal Opinions**

Section 609.6(b)(18) of the proposed rule requires that an applicant provide copies of "all legal opinions and other material reports, analyses and reviews related to the project." Legal opinions relating to the project and the financing are unlikely to be prepared and available until much closer to financial close (not at the application stage) and would be provided to DOE at that time.

## Comments of Nuclear Energy Institute

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To the extent that any legal opinions have been issued prior to the closing, reliance by and disclosure to any third party not an addressee of the legal opinion normally would be limited by the terms of the opinion. Other legal memorandum prepared for the project would be subject to attorney-client privilege that could be lost (making such materials potentially discoverable by third-party litigants) if such materials are provided as part of the application (even if subject to confidentiality under the Freedom of Information Act). Accordingly, we would recommend that the reference to providing "legal opinions" at the application stage be eliminated. Alternatively, the nuclear energy industry recommends that DOE apply the materiality standard to legal opinions as well as to the other reports and analyses covered by this regulation.

Given the long lead time associated with planning for a new nuclear project, there may be legal opinions that relate in some way to the project, but that may never have been (or are no longer) material to the project by the time the loan guarantee is sought. Such legal opinions could relate to matters such as long-resolved questions about permitting or licensing, employment claims, or organizational structures for the project that are no longer under consideration. A materiality limitation would reduce the burden on DOE to review irrelevant materials while protecting potentially sensitive attorney-client matter.

### 3. Deviations

The proposed rule (§609.18) provides: "To the extent that such requirements are not specified by the Act or other applicable statutes, DOE may authorize deviations on an individual request basis from the requirements of this part (except environmental considerations and requirements) upon a finding that such deviation is essential to program objectives and the special circumstances stated in the request make such deviation clearly in the best interest of the Government. Recommendation for any deviation shall be submitted in writing to DOE. Such recommendations must include a supporting statement, which indicates briefly the nature of the deviation requested and the reasons in support thereof. Any deviation, however, that was not captured in the Credit Subsidy Cost will require either additional fees or discretionary appropriations."

The nuclear industry agrees that a provision on deviations is necessary in order to provide flexibility in implementing the program. Project-specific issues may arise in the loan guarantee process that cannot be contemplated in advance in the regulations. We also agree that any deviations that affect the credit subsidy cost must be appropriately reflected in the cost and in the payment of fees.

We believe the criteria for DOE approval of deviations are neither feasible nor appropriate, however. The proposal establishes an unnecessarily limiting standard ("clearly in the best interest of the Government"). There could be circumstances where proposed deviations may benefit project risk management or lower costs, but may not otherwise materially affect the interest of the government. Also, the use of the word "clearly" is a judgmental term that will be difficult to administer.

We recommend that the criteria for approval be modified to state that deviations will be authorized "if the project sponsor and DOE agree that such deviation will mitigate project risk, reduce project cost, enhance project implementation, ensure the reasonable prospect of repayment or otherwise facilitate the purposes of Title XVII."

**Comments of Nuclear Energy Institute**

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**Appendix I**

**March 7, 2007, Letter from Bankers to Energy Secretary Samuel Bodman**



March 7, 2007

The Honorable Samuel W. Bodman  
Secretary  
U.S. Department of Energy  
1000 Independence Avenue, S.W.  
Washington, D.C. 20585

Dear Mr. Secretary:

Attached, please find a summary of the consensus views of five major U.S. banking institutions (Citigroup, Credit Suisse, Goldman Sachs, Lehman Brothers, and Morgan Stanley) on the Title XVII loan guarantee program authorized by the Energy Policy Act of 2005.

We believe loan guarantees are essential to support the financing in the credit markets of new nuclear power plants in the United States. We are providing our perspective in the hope that it will assist the Department of Energy in developing regulations to implement this essential program. We regard the attached summary as a set of minimum conditions necessary to secure financing from lenders and from investors in the fixed income markets.

We would appreciate the opportunity to meet with you or your senior staff, at your convenience, to discuss the issues raised in the summary, and we are anxious to work with the Department of Energy in structuring a workable financing instrument to support construction of new nuclear power plants in the United States.

Respectfully submitted,

Rukmini Roy, Managing Director  
Export and Agency Finance Group  
Citigroup Global Markets, Inc.

Joseph Sauvage  
Managing Director  
Lehman Brothers Inc.

Steven Greenwald, Managing Director  
Jonathan Baliff, Managing Director  
Alex Kroner, Director  
Credit Suisse Securities (USA) LLC

Ray Spitzley  
Managing Director  
Global Power and Utilities Group  
Morgan Stanley & Co Incorporated

H. John Gilbertson Jr.  
Managing Director  
Goldman, Sachs & Co.

**Loan Guarantees for Advanced Nuclear Energy Facilities**  
**Bankers' Viewpoints on DOE Implementing Regulations**  
**(Developed by Citigroup, Credit Suisse, Goldman Sachs, Lehman Brothers, Morgan Stanley)**

Summarized below are the consensus views of a group of leading bankers regarding the "must-have" financial support needed from the U.S. Department of Energy ("DOE"), under the Energy Policy Act of 2005 (the "Act"), to enable the construction of new nuclear facilities in the United States.

**Loan guarantees are a necessity.**

We believe new nuclear construction projects will not have access to the credit markets in order to finance such projects during construction and initial operations without the support of a federal government loan guarantee. Lenders and investors in the fixed income markets will be acutely concerned about a series of major risks, including the possibility of delays in commercial operation of a completed plant or "another Shoreham". We believe these risks will make such lenders unwilling at present to extend long-term credit to such a project in a form that would be commercially viable.

We also believe that the standby support "insurance" is inadequate to address these risks and that a number of the conditions in DOE's initial guidelines for the loan guarantee program, if carried forward into the final regulations, would make that program unworkable for purposes of financing new nuclear power projects. To be commercially viable, the loan guarantee program would need at a minimum to have the following terms:

**1. Limited term of the guarantee.**

We believe that debt need not be guaranteed for the full 30 years permitted by the Act. Instead, the guarantee will need to cover the period of construction plus at least 5 years (and preferably up to 10 years to provide flexibility with respect to refinancing) following the completion of construction and the commencement of operation. Various structures could be used to achieve financing with a limited term guarantee.

**2. Loan guarantee covers 80% of total project cost.**

The guarantee would cover all of the senior secured debt of each project, up to a maximum of 80% of the total project cost, as stipulated by the Act. The project sponsor would be left to decide upon the form of the remaining capital to be invested.

We believe the "80% of 80%" loan guarantee concept which was included in an earlier draft of DOE regulations will not work because it will not be possible to fund the remaining "20% of 80%" in the un-guaranteed debt markets on commercially reasonable terms.

**3. Guarantor.**

The guarantor is the United States Department of Energy with the full faith and credit of the United States of America.

**4. Guarantees are 100% unconditional.**

The guarantees must be 100% unconditional and viewed as "AAA" credit quality by the major rating agencies and lenders. This would mean there is absolutely no reason until after the maturity date of the guarantee that they would not be fully enforceable.

## **5. Scope of the Guarantee.**

Coverage of all principal, interest, obligations with respect to Letters of Credit, interest rate hedging obligations and other credit instruments which are senior secured obligations of the project, subject to the 80% of project cost limit noted above.

## **6. Non-recourse.**

All debt will be non-recourse to the project sponsors.

## **7. Collateral.**

First priority security interest over all project assets and contracts.

## **8. Events of default.**

There would be customary events of default which would permit the lenders to declare the guaranteed loans to be in default and to accelerate their payment. The primary such event of default would be non-payment of any interest and principal due, including the remaining principal amount which is payable at final loan maturity.

## **9. DOE option to remedy default or extend the term of the guarantee.**

DOE would have the option at its sole discretion to extend the guarantee term of a specific project beyond its original term (subject to an agreed maximum term), or to take other steps during the loan term to keep current the guaranteed loan in order to avoid immediate acceleration of the entire principal.

## **10. Syndication or resale of guaranteed loans.**

All guaranteed obligations may be syndicated or otherwise sold in the secondary market, on either a pro-rata basis or in tranches at the discretion of the project sponsor or the beneficiaries of the Guarantee.

## **11. Subsidy cost and calculation.**

There should be a transparent methodology to calculate the Subsidy Cost that will be paid by the project as a loan guarantee fee, and such Subsidy Cost should be reasonable and commercially viable (in line with those of other Federal loan guarantee programs).

Such methodology should stipulate (i) the conditions which might ultimately cause the guarantee to be called (e.g. construction cost overruns, revocation of permits, injunctions, etc.), (ii) the probability of such an event occurring, and (iii) the ultimate recovery which DOE might expect, e.g. "loss given default".

The costs of the Subsidy, as calculated, plus the fees paid for administrative costs, need to be included in and be finance-able as part of the total "project cost".

**Comments of Nuclear Energy Institute**

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**Appendix II**

**May 3, 2007, Letter from House Members to President Bush**

HENRY A. WAXMAN, CALIFORNIA  
EDWARD J. MARKEY, MASSACHUSETTS  
RICK BOUCHER, VIRGINIA  
EDOLPHUS TOWNS, NEW YORK  
FRANK PALLONE, JR., NEW JERSEY  
BART GORDON, TENNESSEE  
BOBBY L. RUSH, ILLINOIS  
ANNA G. ESHOO, CALIFORNIA  
BART STUPAK, MICHIGAN  
ELIOT L. ENGEL, NEW YORK  
ALBERT R. WYNN, MARYLAND  
GENE GREEN, TEXAS  
DIANA DEGETTE, COLORADO  
VICE CHAIRMAN  
LOIS CAPPS, CALIFORNIA  
MIKE DOYLE, PENNSYLVANIA  
JANE HARMAN, CALIFORNIA  
TOM ALLEN, MAINE  
JAN SCHAKOWSKY, ILLINOIS  
HILDA L. SOLIS, CALIFORNIA  
CHARLES A. GONZALEZ, TEXAS  
JAY INSLEE, WASHINGTON  
TAMMY BALDWIN, WISCONSIN  
MIKE ROSS, ARKANSAS  
DARLENE HOOLEY, OREGON  
ANTHONY D. WEINER, NEW YORK  
JIM MATHESON, UTAH  
G.K. BUTTERFIELD, NORTH CAROLINA  
CHARLIE MELANCON, LOUISIANA  
JOHN BARROW, GEORGIA  
BARON P. HILL, INDIANA

DENNIS E. FITZGIBBONS, CHIEF OF STAFF  
GREGG A. ROTHSCHILD, CHIEF COUNSEL

ONE HUNDRED TENTH CONGRESS

**U.S. House of Representatives**  
**Committee on Energy and Commerce**  
**Washington, DC 20515-6115**

JOHN D. DINGELL, MICHIGAN  
CHAIRMAN

May 3, 2007

JOE BARTON, TEXAS  
RANKING MEMBER  
RALPH M. HALL, TEXAS  
J. DENNIS HASTERT, ILLINOIS  
FRED LUTTEN, MICHIGAN  
CLIFF STEVENS, FLORIDA  
NATHAN DEAL, GEORGIA  
ED WHITFIELD, KENTUCKY  
BARBARA CUBIN, WYOMING  
JOHN SHIMKUS, ILLINOIS  
HEATHER WILSON, NEW MEXICO  
JOHN B. SHADDEG, ARIZONA  
CHARLES W. "CHIP" PICKERING, MISSISSIPPI  
VITO POSABELLA, NEW YORK  
STEVE BUYER, INDIANA  
GEORGE RADANOVICH, CALIFORNIA  
JOSEPH R. PITTS, PENNSYLVANIA  
MARY BONO, CALIFORNIA  
GREG WALDEN, OREGON  
LEE TERRY, NEBRASKA  
MIKE FERGUSON, NEW JERSEY  
MIKE ROGERS, MICHIGAN  
BUE HYUN, NORTH CAROLINA  
JOHN EDGAR, OKLAHOMA  
TIM MURPHY, PENNSYLVANIA  
MICHAEL E. BURRIS, TEXAS  
MARSHA BLACKBURN, TENNESSEE

The President  
The White House  
1600 Pennsylvania Avenue, N.W.  
Washington, D.C. 20500

Dear Mr. President:

The Energy Policy Act of 2005 establishes an important program to provide incentives for the deployment of clean energy technologies. Title XVII authorizes the Federal Government to guarantee the debt of certain energy projects that "avoid, reduce, or sequester air pollutants or anthropogenic emissions of greenhouse gases" and "employ new or significantly improved technologies as compared to commercial technologies in service in the United States at the time the guarantee is issued."

Since its enactment, the Title XVII loan guarantee program has faced many challenges. One challenge originating in the Administration has been the discussion of how much of a project's total financing cost may be backed by the Federal loan guarantee. The Act allows the Secretary of Energy to guarantee up to 80 percent of the total capital costs of a project, anticipating that equity investors will pledge the balance of 20 percent.

We have been told that the Administration is considering a generic standard for this program that could generally limit Federal guarantees to 80 percent of the debt portion of a project, or 64 percent of total capital financing requirements. We urge you to not propose such a guideline.

Our request reflects a number of concerns that have been brought to our attention. As a practical matter, this could shift the debt/equity ratio contemplated in the Act to 64 percent debt/36 percent equity. According to independent financial analysts, this is because the non-guaranteed portion of the "debt" share could revert to equity. Given a choice between a fixed return debt investment that is explicitly subordinated to the Federal Government and an unsecured investment that at least offers the opportunity for sharing in a project's profit, the investor would likely choose equity, and investments under Title XVII could suffer.

We are told, however, that for many U.S. projects to be built, investors may be unwilling to shoulder more than 20 percent of the total capital risk of a project. One reason cited is that investors suffered losses in the 1980s when some plants were completed but never operated. Another reason mentioned is that better, less risky investment opportunities in similar plants exist offshore. Project developers compete globally for financing, even for U.S. investment dollars.

That is why Congress authorized the Title XVII loan guarantee program as a keystone of the Energy Policy Act of 2005. We do not want our next generation of critically needed energy projects to be built, owned, and operated by the Federal Government. Given today's financial climate, the types of plants that will meet our growing energy needs without increasing our greenhouse gas emissions are simply not getting built. The loan guarantee program is a crucial bridge to facilitate development of new technologies such as advanced nuclear, renewable energy systems (including cellulosic ethanol), and coal projects that capture and sequester CO<sub>2</sub>.

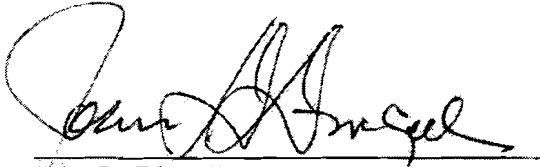
Once a few of these pioneering projects demonstrate success, the risk for similar, follow-on projects will be reduced. The key is to get the first ones financed, built, and operated as soon as possible.

It was not the intent of Congress to waste taxpayer dollars by guaranteeing debt on unworthy projects. Nor do we want projects to enjoy more Federal backing than they actually need, particularly at the expense of other badly needed investments.

We urge the Administration to issue rules for the Title XVII loan guarantee program that do not adopt inflexible standards, that ensure project-by-project scrutiny, and that enable the government to manage risk for the U.S. taxpayers and still attract adequate private investment. Under such rules, and as the program establishes a sound track record, Congress will be more likely to expand funding for the program.

We believe a balance can be achieved under Title XVII between assuming a manageable risk to the Treasury under a well-operated loan guarantee program, while avoiding the unacceptable risk to the Nation of failing to meet our energy needs in an environmentally acceptable manner. That was the intent of Title XVII, and we look forward to working with you to achieve this purpose.

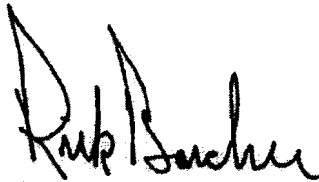
Sincerely,



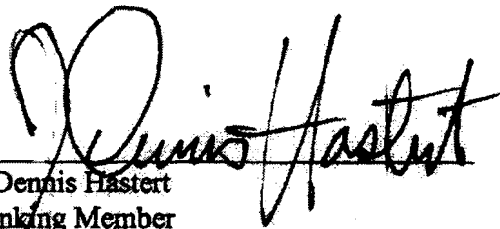
John D. Dingell  
Chairman



Joe Barton  
Ranking Member



Rick Boucher  
Chairman  
Subcommittee on Energy and Air Quality



J. Dennis Hastert  
Ranking Member  
Subcommittee on Energy and Air Quality

**Comments of Nuclear Energy Institute**Department of Energy Notice of Proposed Rulemaking (72 *Federal Register* 27471, May 16, 2007)

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**Appendix III****U.S. Government Loan Guarantee Programs and Percent of Loan Coverage***Fiscal Year 2007*

PROGRAM	Loan Guarantee Amount (000 \$)	Percent Loan Coverage
<b><i>Less than 45% Loan Coverage</i></b>		
Housing Guaranteed Loans	2,826,0360	25
<b><i>45% - 55% Loan Coverage</i></b>		
GSE Risk Sharing	9,000	50
DCA	110,000	50
<b><i>55% - 65% Loan Coverage</i></b>		
Supplier Credit	0	65
<b><i>65% - 75% Loan Coverage</i></b>		
7(a) General Business Loans	17,500,000	72.68
<b><i>75% - 85% Loan Coverage</i></b>		
Minority Business Resource Center	18,367	75
Renewable Energy	154,083	78.43
Health Facilities Construction Loans	8,000	80
Apartment Refinance	2,441,000	80
Health Care Refinance	2,180,000	80
Business and Industry Loans	1,096,282	80.58
<b><i>85% - 95% Loan Coverage</i></b>		
Tax Credit New Construction	928,000	85
Community Facility Loans	20,495	85.44
538 Multi-Family Housing - Subsidized	62,998	89.93
Farm Operating - Unsubsidized	1,151,000	90
Farm Operating - Subsidized	272,250	90
Farm Ownership - Unsubsidized	1,201,000	90
Water and Waste Disposal Loans	75,000	90
Section 502 Single-Family Housing Purchase	4,687,940	90
Section 502 Single-Family Housing Refinance	246,925	90
Housing Finance Authority Risk Sharing	149,000	90
Title I Property Improvement	43,496	90
Title I Manufactured Housing	58,638	90
Indian Guaranteed Loan Program	82,377	90
Indian Insured Loan Program	5,000	90
<b><i>95% - 100% Loan Coverage</i></b>		
Title VI Indian Housing Guarantees	17,000	95
Facilities	26,000	96
GSM 102	1,964,000	98



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<b>PROGRAM</b>	<b>Loan Guarantee Amount (000 \$)</b>	<b>Percent Loan Coverage</b>
Indian Housing Loan Guarantees	251,000	100
Native Hawaiian Housing Loan Guarantees	43,000	100
Community Development Loan Guarantees (Section 108)	138,000	100
Multifamily Development	707,000	100
Section 221(d)(3) Cooperatives	51,000	100
Section 241 Supplemental Loans	4,300	100
Multifamily Operating Loss Loans	2,200	100
Health Care and Nursing Homes	312,000	100
Hospitals	900,000	100
Other Rental	130,000	100
Section 234 Condominiums	3,224,000	100
Section 203(k) Rehabilitation Mortgage	421,000	100
Home Equity Conversion Mortgages	8,939,000	100
Mutual Mortgage Insurance Program	44,418,000	100
TIFIA Loan Guarantees	200,000	100
Risk Category Level 3	23,000	100
Risk Category Level 4	16,500	100
Risk Category Level 5	11,000	100
OPIC Loan Guarantees	450,000	100
OPIC Investment Funds	500,000	100
Section 504 Certified Development Companies Debentures	7,500,000	100
SBIC Debentures	3,000,000	100
Risk Category A	6,551,000	100
Risk Category B	9,309,000	100
<b>FY 2007 Total Commitments</b>	<b>237,998,233</b>	

**Coverage Level Range****2007 Commitments (billion dollars)**

< 45%	28.3
45 - 55%	0.1
55 - 65%	0.0
65 - 75%	17.5
75 - 85%	5.9
85 - 95%	9.0
95 - 100%	177.2
<b>Total</b>	<b>238</b>

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**U.S. Government Loan Guarantee Programs and Percent of Loan Coverage**  
*Fiscal Year 2008*

PROGRAM	Loan Guarantee Amount (000 \$)	Percent Loan Coverage
<b><i>Less than 45% Loan Coverage</i></b>		
Housing Guaranteed Loans	29,104,463	35
<b><i>45% - 55% Loan Coverage</i></b>		
GSE Risk Sharing	11,000	50
DCA	328,000	50
DCA Line of Credit	20,000	50
<b><i>55% - 65% Loan Coverage</i></b>		
Supplier Credit	200,000	65
<b><i>65% - 75% Loan Coverage</i></b>		
7(a) General Business Loans	17,500,000	66.95
Minority Business Resource Center	18,367	75
<b><i>75% - 85% Loan Coverage</i></b>		
Business and Industry Loans	1,000,000	78.22
Renewable Energy	195,469	78.43
Title 17 Innovative Technology Loan Guarantees	9,000,000	80
Apartment Refinance (Legislative Proposal)	2,563,000	80
Health Care Refinance	3,069,000	80
Railroad Rehabilitation and Improvement Financing Guaranteed Loans	100,000	80
Water and Waste Disposal Loans	75,000	82.05
Tax Credit New Construction	1,091,000	85
<b><i>85% - 95% Loan Coverage</i></b>		
Community Facility Loans	210,000	86.05
Farm Operating - Unsubsidized	1,000,000	90
Farm Operating - Subsidized	250,000	90
Farm Ownership - Unsubsidized	1,200,000	90
Section 502 Single-Family Housing Purchase (Legislative Proposal)	4,787,500	90
Section 502 Single-Family Housing Refinance	61,111	90
538 Multi-Family Housing - Subsidized	200,000	90
Housing Finance Authority Risk Sharing	156,000	90
Title I Property Improvement	43,496	90
Title I Manufactured Housing	58,638	90
Indian Guaranteed Loan Program	84,506	90
Indian Insured Loan Program	1,000	90
<b><i>95% - 100% Loan Coverage</i></b>		
Title VI Indian Housing Guarantees	17,000	95
Facilities	26,000	96

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<b>PROGRAM</b>	<b>Loan Guarantee Amount (000 \$)</b>	<b>Percent Loan Coverage</b>
GSM 102	2,214,000	98
Indian Housing Loan Guarantees	367,000	100
Native Hawaiian Housing Loan Guarantees	41,504	100
Multifamily Development (Legislative Proposal)	848,000	100
Section 221(d)(3) Cooperatives	102,000	100
Section 241 Supplemental Loans	6,500	100
Multifamily Operating Loss Loans	3,300	100
Health Care and Nursing Homes	339,000	100
Hospitals	900,000	100
Other Rental	324,000	100
Mutual Mortgage Insurance Program (Legislative Proposal)	56,996,000	100
Mutual Mortgage Insurance Program-HECM (Legislative Proposal)	25,000,000	100
TIFIA Loan Guarantees	200,000	100
OPIC Loan Guarantees	450,000	100
OPIC Investment Funds	500,000	100
Section 504 Certified Development Companies Debentures	7,500,000	100
SBIC Debentures	3,000,000	100
Risk Category A	4,671,000	100
Risk Category B	14,043,000	100
<b>FY 2008 Total Commitments</b>	<b>289,356,460</b>	

<b>Coverage Level Range</b>	<b>2008 Commitments (billion \$)</b>
< 45%	29.1
45 - 55%	0.4
55 - 65%	0.0
65 - 75%	17.7
75 - 85%	16.0
85 - 95%	9.1
95 - 100%	217.0
<b>Total</b>	<b>289.4</b>

*Source: EOP Group, Inc. from budget documents*

#### **Appendix IV**

##### **Illustrative Project Risk Evaluation Criteria**

The nuclear industry proposes that the Department focus the loan guarantee program design on credit analysis and underwriting of the kind any bank would employ to lend money. We believe the pending rulemaking should establish a set of risk-based evaluation criteria to ensure that credit risks are rigorously analyzed, quantified, scored and appropriately priced or mitigated. The Department then should have the ability to structure loan guarantees that will enhance the statutory objective of commercializing innovative technologies, with projects that are financially sound and have the financial capacity to repay the underlying loan obligation guaranteed by the U.S. government.

Set forth below is an illustrative set of criteria, based on standard project finance credit analysis. This illustrative set of evaluation criteria are preliminary and need to be tailored to the specific project being developed, taking into account particular sectors or technologies. The evaluation criteria have been successfully utilized by project sponsors, lenders and project participants in the financing and construction of power projects over the last 25 years. Implementation of the evaluation criteria through an effective underwriting and Credit Review Board process utilizing outside experts. This process would be supplemented by third party consultants and reports that are standard for project financings, such as independent engineers, fuel consultants, insurance advisors and market studies.

##### **Illustrative Evaluation Criteria**

###### **A. Management and Financial Strength**

###### **1. Sponsor/Developer Strength and Support**

- quality and commitment to project
- experience and track record in sector
- credit ratings
- equity commitment
- other equity support

###### **2. Management Strength**

- expertise and experience of key project management personnel (both construction management and operating management)

###### **3. Lender Strength and Commitment**

- lead/managing agents/underwriters
- lender qualifications (expertise, experience and financial strength)
- level of lender risk sharing
- level of project oversight and diligence
- asset management capabilities

###### **4. Financial Strength of Project**

- financial structure

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- debt to equity ratio
- debt service coverage ratio (interest and cash flow)
- sensitivity analysis on all key assumptions
- recovery analysis in a default scenario
- debt service and other reserves
- security/collateral arrangements
- insurance package
- credit enhancements

**B. Pre-Completion/Construction Risk**

**1. Cost and Schedule Risks**

- extent of project-specific engineering and design work completed
- degree of standardization with other projects
- status of site plans, evaluations and permits
- extent of independent engineer review of design, cost and schedule
- appropriateness of cost contingency amounts
- qualification, experience and financial strength of contractors and major subcontractors
- clarity on interaction and coordination among contracts and parties required to implement the project
- change order process

**2. Labor and Material Risks**

- contractor staffing requirements and labor relations and supply
- availability of critical materials and supplies
- long-lead procurement items

**3. Contractual Structure and Completion Support**

- existence of contract for engineering, procurement and construction with acceptable scope and budget
- existence of contract that controls risks related to price
- existence of adequate security for payment, such as letters of credit, bonds or other form of guarantee
- testing and commissioning requirements
- performance guarantees
- liquidated damages and penalties (performance and delay)

**4. Force Majeure Risks**

**5. Construction Period Insurance**

**6. Connecting and Other Infrastructure**

- fuel transportation
- interconnection (transmission lines, upgrades)

**C. Operation Risk**

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1. Operator Strength
  - qualification, ability and financial strength of operator
  - operator compensation structure
  - operations and maintenance agreement
2. Operating Cost Risks
  - makeup, timing and potential volatility of operating costs
  - operating budget control mechanisms
  - degree of standardization with other projects
3. Input/Supply Issues
  - supply and transportation of key inputs (e.g., feedstock, fuel)
  - availability
  - pricing and cost volatility (hedging arrangements)
  - liquid markets or long-term supply contracts (consistency with offtake pricing)
  - credit quality of suppliers
4. Performance
  - capacity and availability standards
  - routine and major maintenance
  - spare part requirements
  - future capital investments
  - warranties
5. Output Transportation/Transmission Arrangements
6. Waste Disposal
7. Force Majeure Risks
8. Operations Period Insurance
- D. Technology Risk**
  1. Technical Design
  2. Manufacturer – counterparty risk
  3. Technical Readiness
    - scale of previous operation
    - use of proven technology, components and designs
    - extent of previous operating data and record of performance
    - prior independent technical design certifications
    - extent of design proof through full-scale or partial-scale testing
  4. Feasibility Study
  5. Mitigants
    - warranties

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- performance guarantees

### **E. Off-take Risk**

1. Long-term off-take agreements or liquid markets
2. Off-take Agreements
  - credit strength and performance risk of off-take counterparty
  - length of term of off-take contract
  - pricing mechanism (consistency with input and capital costs)
  - quality, quantity or efficiency/availability impact on obligation to purchase and cash flows
  - take or pay obligations
3. Market/Commodity Risk
  - market pricing and degree of volatility
  - liquidity of product markets
  - demand projections, including size of market relative to project output
  - project production cost and other project competitive advantages relative to market and competitors
  - potential for new contracts, new products, product substitution or other factors that could affect demand or supply in the market
4. Physical/Financial Hedging-security arrangements

### **F. Legal, Regulatory and Permitting Issues**

1. Legal
  - organizational structure/ownership
  - use of bankruptcy remote special purpose vehicle
  - project, loan and security contractual structure and enforceability
2. Regulatory/Permits - Federal/State
  - regulatory environment for project inputs and output and project operations
  - environmental and other site permits
  - construction
  - operating
  - fuel/fuel transportation
  - waste/combustion by-product disposal (e.g., nuclear fuel, coal ash)
  - risk of change in law or regulations and impact on project
3. Accounting and Tax Issues

## Appendix V

### **Analysis Of Prior DOE Regulations And Case Law Involving *Pari Passu* Financing Structures**

As noted above (page 14 of these comments), NEI believes DOE has misinterpreted the “superior rights” provision (Sec. 1702(g)(2)(B)) as prohibiting *pari passu* financing structures and prohibiting any holders of non-guaranteed debt from recovering on their debt until DOE’s claim is paid in full. Section 1702(d)(2), which provides that the obligation guaranteed by DOE cannot be subordinate to other financing, clearly permits *pari passu* financing (where senior lenders share equally and ratably in right of payment and in the security in proportion to their debt). DOE’s interpretation is not only contrary to this statutory structure, it is inconsistent with prior DOE regulations and case law interpreting identical language.

Section 1702(g)(2)(B) is identical for all intents and purposes to the last sentence of 42 U.S.C. §5919(g)(2) which was enacted in 1978 as part of the Loan Guarantees for Alternative Fuel Demonstration Facilities program. DOE’s regulations implementing that provision provided as follows:

(f) The guarantee agreement shall provide that, upon payment of the guaranteed loan by the Secretary, the holder shall transfer and assign to the Secretary all rights held by the holder in the guaranteed loan. Such assignment shall include all related liens, security, and collateral rights. Upon such payment and assignment, the Secretary shall be subrogated to the rights of the recipient of the payment and shall have superior rights in and to the property acquired from the recipient of the payment. Where there is a partial guarantee of the loan, the guarantee will specify the terms and conditions for the handling of collateral and the disposition of the proceeds of recovery after liquidation of the security. (emphasis added) 10 C.F.R. § 796.60(f) (45 Fed. Reg. 15487 (1980) (removed 60 Fed. Reg. 49196 (1995))).

These regulations did not prohibit a *pari passu* structure. In fact with respect to payments on partial guarantees, the regulations provided for *pari passu* treatment (“When a lender holds a guaranteed and a nonguaranteed portion of a loan, payments of principal or interest made by the borrower, shall be applied by the lender to reduce the guaranteed and nonguaranteed portions of the loan on a proportionate basis.” (emphasis added) 10 C.F.R. 796.11(a)(11) (45 Fed. Reg. 15478 (1980) (removed 60 Fed. Reg. 49196 (1995))). With respect to collateral, the 1980 regulations clearly contemplated sharing of collateral and an intercreditor arrangement to be negotiated in the guarantee that would be typical for a *pari passu* structure.

Other language in the 1980 regulations provided that “[a]ny loan for the project which is not part of the guaranteed loan is subordinate to the guaranteed loan, and the guaranteed loan is in a first lien position . . .” (Id. at 796.11(a)(9)). However, this provision does not undermine the position that the 1980 regulations implementing virtually identical “superior rights” statutory language permitted *pari passu* structures and collateral-sharing arrangements. First, the discussion of this subsection in the rulemaking make it clear that this provision was implementing a provision of the statute that prohibited subordination of the guaranteed loan, as compared to prohibiting *pari passu* structures or requiring priority (“Subsection 19(c)(4) of the Act requires that the obligation being guaranteed not be subordinate to any other financing. . . . Subsection 796.11(a)(9) of the proposed regulation required that the guaranteed loan not be subordinate to any other loan for the project . . . .”) (45 Fed. Reg. 15471(1980), emphasis added). Second, as discussed below, the rest of Subsection 796.11(a)(9) explicitly permitted collateral-sharing arrangements where collateral assets are subject to prior financing liens by other creditors. Finally, this



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language referencing subordination of “any loan . . . not part of the guaranteed loan” could not have been intended to cover partial guarantees (or more specifically, required the subordination of the nonguaranteed portion of a partially guaranteed loan) because, as noted above, Subsection 796.11(a)(11) provided for proportionate (not subordinate) application of payments in the case of partial guarantees and Subsection 796.60(k) provided for proportionate application of liquidation proceeds (“[i]f a partial guarantee is involved, funds received by the lender as a result of liquidation actions will be applied as follows: (1) First, to [liquidation expenses] . . .; and (2) Second, distributed among the legal owners of interests in the loan, prorated in accordance with their relative percentage ownership of the loan.”). This provision explicitly required pro rata sharing of collateral proceeds “if a partial guarantee is involved” – that is, it required a *pari passu* collateral structure for partial guarantees.

Moreover, in a case interpreting 42 U.S.C. § 5919(g), the Eighth Circuit held that the “superior rights” provision granted superior rights to the United States over the debtor’s rights to the property upon default under state law (specifically, debtor’s statutory rights of redemption) U.S. v. Great Plains Gasification Associates, 813 F.2d 193 (8th Cir. 1987). The case focused on the debtor’s statutory and equitable rights to the property upon default that absent the “superior rights” provision, would have been superior to the rights of the lender. The court found that while Congress had not explicitly dealt with the debtor’s redemption rights, it did provide for the procedures to be followed upon default and had granted superior rights to the United States over the debtor with respect to the property in the foreclosure (i.e., the property acquired by subrogation pursuant to the guarantee). Thus, the “superior rights” provision addresses the federal government’s rights in property it acquires after default and subrogation in relation to the debtor and other persons, but does not address the issue of the federal government’s or guaranteed lender’s share or interest in the collateral in the first instance. The case did not involve a partial guarantee. The project was financed by a loan from the Federal Financing Bank, which loan was guaranteed by DOE and secured by a mortgage on virtually all partnership assets.

But applying the case in the context of a partial guarantee, we can readily see that the “superior rights” provision does not preclude a *pari passu* structure. In a partial guarantee, upon default and payment, DOE would be subrogated to the rights of the guaranteed lender but only to the extent of the partial guarantee. In a *pari passu* structure the guaranteed lender would have a first lien in the security, equally and ratably, with the other senior lenders. Upon default and payment on the partial guarantee, DOE’s ratable interest in the security that it obtains through subrogation would be a first lien. DOE would have superior rights with respect to the property acquired through foreclosure. As a practical matter, the collateral would be held by a collateral trustee and the terms and conditions for handling of collateral and the disposition of the proceeds would need to be addressed in an intercreditor agreement (as contemplated by the 1980 regulations) – but to the extent the collateral is sold in foreclosure, DOE would have superior rights to its ratable share of the proceeds. The 1980 regulations and the case law, as well as the statutory structure of Title XVII, support the position that the “superior rights” provision relates to the rights of the Secretary after default and in connection with foreclosure once the Secretary has been subrogated to the rights of the guaranteed lender, and the statute does not preclude a *pari passu* structure.